A.T. & T. PROPOSED SETTLEMENT

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BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

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ON

A.T. & T. PROPOSED SETTLEMENT

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A.T. & T. PROPOSED SETTLEMENT

MONDAY, JANUARY 25, 1982

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, D.C.

The subcommittee met at 10 a.m. in room 235 of the Russell Senate Office Building; Hon. Robert Packwood (chairman of the committee) presiding.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. The hearing will come to order.

In order to accommodate the schedules of some of the witnesses, we will hear from Attorney General Baxter last. He is testifying before the Judiciary Committee at the moment on the IBM and A.T. & T. settlements. We will take Charlie Brown first, because the Judiciary Committee wants him when he's done here. I don't know if he would prefer that we kept him here a long time or let him get down there. And then we will take the Commerce Department second, and General Hilsman third, and as I say, Mr. Baxter fourth.

When this committee passed S. 898, it was very clearly our intention, as evidenced by the fact that we made the Joint Board statutory, that we intended long-distance rates would continue to subsidize residential and rural rates. There was nothing hidden about that intention in the bill. It was discussed, and we never had any thought other than that, and that is the reason we made the Joint Board, which is the Board that determines the access charges statutory.

One of the big issues that has arisen since the consent decree is the issue of whether or not the consent decree, means an increase in local rates.

I would appreciate it if the witnesses would address themselves to that, among other questions that they choose to touch on, as it was clearly not the intention, as evidenced in S. 898 that local rates would go up because of the separation that we decreed in that bill. Also I would appreciate it if at least Mr. Brown would address himself to the yellow pages issue. As you recall, in S. 898, we had a 4-year phase-in of the revenues of yellow pages, before they were totally transferred from the local operating companies. As I recall, under the consent decree, A.T. & T. will keep the yellow pages.

That's the only opening statement I have. Barry?

OPENING STATEMENT BY SENATOR GOLDWATER

Senator GOLDWATER. I think this settlement was one of the wisest decisions that's ever been reached in my life, because I don't think anybody in this room would be alive when the court ever got through that case. I would hope the fact that we're holding this hearing this morning, and the House will undoubtedly do so too, will not encourage a great number of bills to be introduced on the subject, because frankly, we don't know, and I don't think we'll know for a period of 2 years, just where legislation might be needed, if needed at all. I am not skeptical about this move. I can recall—of course, the older you get, the more you recall—but I remember making long-distance calls to home from the school I went to in Virginia, and they cost $25 and took 24 hours to get through. And today my grandchildren can run up a $25 bill in about 5 minutes, just by dialing.

So I'm glad you're holding this hearing, and I hope we get enough on the record so that our colleagues in the Senate and in the House can understand what this means and will mean, and then pray that we're not deluged with a lot of legislation prompted by local politics.

The CHAIRMAN. Jack?

Senator SCHMITT. Thank you, Mr. Chairman. Let me start by saying it's great to see our distinguished subcommittee chairman back with us.

Senator GOLDWATER. Thank you.

Senator SCHMITT. He's looking healthy for a change.

Senator GOLDWATER. Well, I ought to be. I spent a lot of money on it.

OPENING STATEMENT BY SENATOR SCHMITT

Senator SCHMITT. We had a hard enough time dealing with him when he was hurting. God only knows what we're going to have to put up with now.

Mr. Chairman, I'm really not satisfied yet, by any means, that the proposed modification of the 1956 consent decree is necessarily in the public interest. I can't say that it is, I can't say that it isn't. And I must admit that maybe a little bit of my reluctance to accept it at face value is my feeling that the Department of Justice throughout this last year has persistently ignored what was going on over here in the Congress. This consent decree certainly does not reflect the inclinations of the U.S. Senate or of this committee, and I must confess that I must—as I have before—have serious reservations about the direction that Mr. Baxter was leading us in in the negotiation of this agreement.

Despite the 60-day public comment period ordered by Judge Greene, the magnitude of the proposed divestiture of the operating companies and the possible ramifactions, causes me great concern. Since 1977 this committee has been deeply involved in an effort to rewrite the outdated 1934 Communications Act. Because of that involvement, it seems to me that the proposed 1982 decree raises as many questions as it supposedly answers.

First, how can universal service be assured in this environment, particularly for rural subscribers, at a fair price and reasonable prices for all local subscribers? What safeguards are required to insure that national defense security and emergency preparedness concerns are met? Can we reduce uncertainties and eliminate needless and costly regulation to allow U.S. telecommunication firms to meet growing international competition?

To those of us that have been involved with S. 898 and its predecessors, those questions will sound familiar. Chairman Packwood identified these concerns in the first day of hearings on S. 898 last year, and certainly they were recognized in even the first draft of a Republican minority bill that was reduced several years ago. These are the same questions that immediately come to mind when I review this proposed consent decree, and so one could say we really haven't answered any questions, we've just raised them once again. But I do welcome the opportunity to question the distinguished witnesses that will be before us today and hope that it will clarify my deep concerns about this proposed agreement. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gorton? I might say before Senator Gorton speaks, that he and I conducted a hearing on cable television in Seattle last week that was one of the best hearings, field, or Washington, that I've ever seen. There were 2 panels of 10, and every single person that testified—obviously, they didn't agree, there were some mayors and some cable owners, but every single one of them was good.

Senator GOLDWATER. I'm glad to hear it.

The CHAIRMAN. The record was just exemplary. Senator Gorton?

Senator GORTON. Thank you for that, Senator. I agree with you. I have no opening statement today.

The CHAIRMAN. Senator Riegle?

OPENING STATEMENT BY SENATOR RIEGLE

Senator RIEGLE. Thank you, Mr. Chairman. First of all, let me commend you for calling this hearing on such a timely basis. I think it's important to note that when this committee acted previously to bring forward a deregulation bill with respect to telecommunications competition, we did so with the idea that in the end this would be a benefit to consumers. Clearly that was part of the intent of the bill, the stated intent of the bill. And as a matter of fact, some of us who had a particular concern about it, offered amendments that would make sure that the deregulation process would not get out of control in a way that would be harmful to consumers.

In fact, I offered a specific amendment that would require congressional oversight hearings each year to make sure that we were monitoring the process to assure that consumers and others were not being hurt. And that amendment was adopted and became part of the legislation. In Michigan today, Mr. Chairman, there is a great sense of alarm by rank and file citizens, and, I might say, across party lines about the impact of the Justice Department action in this case. The concern is essentially focused on the issue of what's going to happen to local phone rates. Are people going to find themselves facing 200 or 300 percent increases over the period of the next 2 or 3 years in their local phone service. Their obvious concern is if that were to happen, many of them would feel that they could not even maintain their phone service.

Many senior citizens, particularly, would feel that was just something that they could not manage on what are already very tight budgets that they're having to deal with. And the public service commission in my State, which is appointed by the Governor, who happens to be in the other party from mine, is presently conducting a series of public meetings across the State of Michigan, focusing on their concern about this committee's bill and presumably now upon the actions of the Justice Department in this case.

So I might say to you that there is enormous public concern and interest in this issue. And as I say, there is a fear that local rates may just start skyrocketing, if this is carried forward without specific steps being taken to see that rates for local service are kept at a reasonable and fair level. I won't take the time of the committee at the outset to quote directly from letters that I am receiving, but I would ask unanimous consent to insert in the committee record [1] a sampling of letters from citizens of Michigan, who are making it very clear how they feel and what their concerns are, and would ask that they appear at an appropriate time.

The CHAIRMAN. They will be in the record.

Senator RIEGLE. Thank you. And I would conclude by saying that I think it is absolutely essential, and I will be part of an effort on this committee, hopefully with others, to see to it that we build in whatever safeguards are needed in order that local service units of telephone customers will not be priced out of reach. There is absolutely no reason for that to happen, and I think it would be injurious to the public interest, and it would be needlessly hurtful to people to find themselves in that situation. And I trust that with effort, we can find an accommodation here to get the benefits of deregulation in the competitive sense, so we can meet foreign competition and, at the same time, handle the local service problem in a way so that citizens in this country will not be faced with an economic burden they can't manage.

I think we can keep phone rates down. I think we should. And I'm determined to do everything I can in my behalf to see that that happens. Thank you, Mr. Chairman.

Senator GOLDWATER. I might say after yesterday, Michigan will never be the same.

Senator SCHMITT. Mr. Chairman, I think it's important to recognize that the issue of maintaining reasonable local rates is not a new one before this committee. It was, I think, the cornerstone of all of the discussions we've had through the years in rewriting the 1934 Communications Act; if it was necessary to have any form of divestiture or any form of fully separated subsidiary, there would be a loss of capability to cross-subsidize from the profits of one portion of the telecommunications industry to the local phone rates, which generally was accepted should be maintained at reasonable rates, meaning below cost.

The solution to this in S. 898 was the concept of an access surcharge. I think it's an excellent concept, one that evolved through discussions with both minority and majority members of this committee, and it's one that we must keep in mind as we look to see whether the proposed consent decree really is in the public interest. It is clearly a basic tenet of the Senate, that local phone rates be maintained at a reasonable level and, at least for the foreseeable future, below cost.

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[1] See p. 91.

The CHAIRMAN. Let me explain to the audience once more, if I might, how the present system operates, so that if you're covering this or listening, you'll understand what we're driving at. There is a board known as the Joint Board, composed of some members of the Federal Communications Commission and some members of State public utility commissions. The Joint Board determines what's known today as "separations." Translated, that's simply the subsidy from long distance to local. And all of the local phone companies in this country, from General Telephone and Electric on down to the little companies, receive payments as subsidies for long distance. We simply changed the name of "separations" to an access charge in the bill that passed this committee, and again, this simply means the charge, in essence, that is going to be paid to tie into the local line. And we then said that the Joint Board would be statutory, and they will have an obligation to keep local phone rates reasonable, and that the local phone rates could not go up more than 10 percent above the national average in any year. And that's all statutory.

I can find nothing so far in the consent decree that mentions the Joint Board or affects the Joint Board or has anything to do with the Joint Board.

Senator SCHMITT. Mr. Chairman, if you'd yield for one further comment, I think we have to recognize that the decisions of the courts in recent years and the administrative actions of the FCC have already eroded the base for cross-subsidy of local phone rates. And that has been one of the principal pressures on us to do something statutorily, in order to create some other mechanisms that will begin to reduce the already existing upward pressure on rates that has come from the court and administrative actions of recent years.

The CHAIRMAN. We will start with Mr. Charles Brown, the chairman of the board of A.T. & T. I've indicated that the witnesses need not hold themselves to the 5 minutes we usually impose. These are matters of sufficient magnitude that we'll go beyond that.

Mr. Brown.

STATEMENT OF CHARLES BROWN, CHAIRMAN OF THE BOARD, A.T. & T.

Mr. BROWN. Yes, sir. Thank you for the opportunity to speak to you and the committee this morning, Mr. Chairman. I intend, with your permission, to briefly describe the consent decree modification which was proposed by the Department of Justice and accepted by the American Telephone & Telegraph Co. I propose also to answer your questions about why we decided to accept this decree. It clearly is a breakthrough, and I feel a giant step in trying to carry out the telecommunications policy which, in large part due to the work of this committee, has emerged as a consensus in this country.

We believe that this consent decree greatly eases the situation and eases the task of Congress in its desire to supplant the existing, outdated 1934 act. First, what does the modified consent decree mean? It means that A.T. & T. will divest two-thirds of its assets, local parts of 22 operating companies throughout the country, 18 months after the approval of the decree by Judge Green.

The divested companies, in accordance with the decree provisions, will have to have sufficient people, facilities, technical information, and balance sheet stability to do the job. A.T. & T., Bell Labs, and Western Electric Co. are obligated to provide R. & D. and manufacturing services required by these companies to implement the decree. A.T. & T.'s license and supply contracts with these companies will be terminated. Divestiture will take the form of either spinoff to our stockholders or sale, or a combination of these.

Nothing in the decree changes employee benefits, pensions or existing union contracts. The decree specifies that there is no admission of violation of any antitrust laws. A.T. & T. retains the long-distance network, the Bell Telephone Laboratories, the Western Electric Co., and the terminal equipment, that is telephones, PBX's, and so forth, and the restraints of the 1956 decree are removed.

Why did we agree to such a drastic change in this company's structure? We did so because we believe the signals are clear with respect to emerging national telecommunications policy and also the structure of this industry. We are confident that this decree is consistent with the intent of Congress.

We believe the provisions clear the way for promptly accomplishing some very specific objectives. First, to encourage competition where competition is desirable, without, I would emphasize, in the least diminishing the authority of regulatory agencies to insure good phone service at prices everybody can afford. Second, to eliminate even the potential for cross-subsidization among the existing Bell companies, and thereby clear the way for the removal of the arbitrary and cumbersome prohibitions which otherwise have been proposed. Third, to preserve the resources as well as the mechanisms which insure that our country's communication system can effectively respond to the requirements of national security. Fourth, to put in place now an industry structure which may help pave the way toward some deregulation in the future. Fifth, to retain the research, development, and manufacturing resources which currently give America its world leadership in communications technology. In the long run, that's the surest means to protect the jobs of American workers.

Let me sum it up this way, Mr. Chairman. Divestiture is not our idea. Frankly, it goes down very hard. But what matters in the end is not whether we like it or not. What matters is how and how soon Bell companies undertake to conform themselves to the requirements of a new national policy. Under the circumstances and in view of the options available, the consent decree modification accomplishes these ends.

The matter of local rates has undergone considerable discussion here and in other forums. It has been erroneously said that this decree will have a major effect on increasing local rates. This is not so. The regulators now have, and in the future retain the mechanism to continue the subsidy of long-distance rates to local. As far as Yellow Pages are concerned, although the subsidy will be affected by this decree, this is also true under most legislative proposals that I have heard of. The only difference is the timing.

Entirely apart from the decree, and as we have been saying for a long, long time in this forum and in others, rates will go up for other reasons. They've been going up at about 4 percent in recent years, well below any inflation rates in this country. We would expect that they would go up at about 8 to 10 percent in oncoming years. Why?

In the first place, inflation. Although the Bell System's productivity has been four and five times the national average, it cannot eat all the effects of inflation. Second, changes over the years in the way the regulators calculate the subsidy from long distance to local. Third, accounting changes which put the cost of installations, moves, and changes on the customers who order them, rather than spreading them over all the customer body. And fourth, depreciation. Competition and technology changes shorten lives, and this means depreciation changes and rate increases.

What does all this mean for the average customer? A relatively small increase under these circumstances and having nothing to do with the consent decree. The average monthly rate for local service in this country is about $10. We'd expect that to increase each year for the next few years by less than $1. I repeat, these mechanisms, these effects, are underway now and, as we have been saying for a dozen years, will continue to be underway. They are under full control of the regulators. The consent decree has little or nothing to do with this situation.

Mr. Chairman, perhaps I can stop now and answer any questions you and the committee may have.

The CHAIRMAN. Mr. Brown, I think we'll limit ourselves to 5 minutes apiece on questions and go around as often as we want, until we are done. Let's talk about the Yellow Pages. I don't quite find in the consent decree what is going to happen to the Yellow Pages. If there is a transition period, what happens to the revenues during the transition period? Can you fill us in a bit?

Mr. BROWN. Revenue subsidy from Yellow Pages to local telephone companies is relatively small compared to these other things we've been talking about. The decree follows the Department of Justice's theory which is that the local telephone companies should be confined to local service and access, period. In order to accomplish this, the Yellow Pages, which is now part of their business, and the terminal business will remain with the A.T. & T. Co. The local telephone companies have considerable control over the basis for the yellow page business, that is, the listings, the physical telephone company number listing which, of course, feed the Yellow Pages and feed the competitive yellow page directories also. So there is a control within the local telephone companies on how much they charge for those listings and under what conditions they provide them.

The CHAIRMAN. I'm not quite sure I follow you on this. A.T. & T. will get the right to market the Yellow Pages?

Mr. BROWN. Yes. It owns the companies now, and the companies will not be able to do it in the future.

The CHAIRMAN. Because they are going to be precluded from doing it?

Mr. BROWN. Right.

The CHAIRMAN. Now, what advantage is left with the local phone companies, in terms of revenues from those Yellow Pages?

Mr. BROWN. Clearly, the Yellow Page revenues will not be a part of the local telephone company revenues. As you pointed out, that was going to phase out anyway under most legislation. But there is a mitigating circumstance here and it relates to the listings themselves. In other words, the name and telephone number which is under control of the local telephone company and which they now sell, and in the future which they will continue to sell. So any loss will be mitigated by that.

The CHAIRMAN. So what you're saying, for A.T. & T. to put out the Yellow Pages, you're going to have to buy the listings from local operating companies?

Mr. BROWN. That's right. And this, of course, is a charge which is probably also under the control of the local regulators.

Senator SCHMITT. Would the chairman yield on that?

The CHAIRMAN. Would those local listings have to be available at a nondiscriminatory price to anyone else that wanted to buy them for the same purpose?

Mr. BROWN. Yes, sir. And they are now sold to other directory companies by the local phone companies, but it will be the same basis in the future. That's a source of revenue.

The CHAIRMAN. Let me go once more now to the consent decree and the local rates.

You are saying that whether or not this consent decree had ever been entered into, whether or not S. 898 passed in its original or amended form, local rates are going up?

Mr. BROWN. Yes.

The CHAIRMAN. Is there anything in the consent decree at all that would make local rates go up any faster than if we didn't have the consent decree?

Mr. BROWN. No, sir, except for the Yellow Page matter we have been discussing. The subsidy is in full control of the regulators, and the consent decree, of course, can have no effect on the authority of the regulators.

The CHAIRMAN. I want you to emphasize that point again. As far as I can see, there is nothing in that consent decree that prohibits the so-called existing Joint Board from continuing whatever subsidy it chooses to continue.

Mr. BROWN. No, sir. Nothing in the decree. Does not address it, could not touch it.

The CHAIRMAN. And A.T. & T. would be willing, in the transition, to enter into some kind of an agreement similar to what we had in S. 898 on the Yellow Page phase in?

Mr. BROWN. We could certainly take a look at that, Mr. CHAIRMAN.

The CHAIRMAN. I would hope we can do more than look at it, because in some States it is a fair portion of a rate base and I would hate to see that abruptly changed.

Mr. BROWN. All right, sir.

The CHAIRMAN. Senator Goldwater?

Senator GOLDWATER. Mr. Brown, these consent decree provisions do not appear to satisfy the concerns expressed by the Department of Defense and included in S. 898. The consent decree does not provide for a transfer of any employees or facilities specifically for national security. What guarantees do we have that the central Bell operating company contact point will be viable for network planning and will insure the survivability, restorability and credibility of the network?

Mr. BROWN. Well, Senator Goldwater, as I said earlier in my discussion here, this whole thing was not our idea and it is clearly true that from a national defense standpoint, as well as from the standpoint of the way the telephone system operates in this country, we were convinced that the way we were running it was appropriate. However, it's the second best and it's an awful lot better than the third best, which was divestiture of the Western Electric Co. and the Bell Telephone Laboratories, which was also considered by the Department of Justice.

In the decree there are two things which will help to mitigate any problems with national defense here. The first is the permission to establish a centralized staff on the part of the local operating companies. We are now proceeding to identify those functions of the A.T. & T. general department staff which are appropriate for the local telephone companies to run themselves, and this central staff can act as a coordinating agent to insure engineering standards and procedures for these companies acting jointly.

Second, the decree specifically obligates these companies to furnish a central point of contact for national defense, national security matters. This central point of contact, of course, will deal with A.T. & T. and other companies in order to assure a prompt response to DOD and other agency requests and demands. We will make this work.

Senator GOLDWATER. Have you, in your discussions with DOD, found them to be in agreement with your last statement?

Mr. BROWN. We are working with DOD people now to see what is necessary, in their view, to respond to their needs.

And you will be talking with General Hilsman shortly. I would think he would want to respond to your question directly.

But I have to repeat, this whole divestiture was not our idea.

Senator GOLDWATER. One more question. Isn't the need of defense one of immediate accessibility to the entire system?

Mr. BROWN. Yes, sir, it is.

I have to point out the decree maintains, under one centralized control, the whole intercity network, so both intra- and interstate networks are connected under one unitary control.

The response of the operating companies is for the end pieces of services. And, of course, the A.T. & T. maintains control over terminal equipment.

So, I believe that the telephone industry will respond. I think independent companies today, under circumstances where we, of course, do not own them, have responded remarkably well to defense needs without centralized ownership and control. We are expanding that principle, and I do not see any reason why it will not work.

Senator **Goldwater**. Will immediate access to the entire service be possible after divestiture?

Mr. **Brown**. Yes, sir.

Senator **Goldwater**. Thank you, sir.

Senator Schmitt.

Senator **Schmitt**. Thank you, Mr. Chairman.

Without getting into any further detail, I join with Senator Goldwater in expressing concern about the defense thing. As you say, it is not the best, it is second best. What we have to determine in this committee and in our other committee assignments is whether it's adequate. And I am tremendously concerned about the difficulties of an arm's-length coordination of these critical defense and national emergency matters between A.T. & T. and the 22 operating companies.

I share your concern. I know it was not your idea, nor was it the idea of the Congress, that this happened. It is an area that the committee specifically addressed in S. 898, and I think we have to continue to address. I'm just not convinced yet that under the proposed consent decree that we are, in fact, going to see an adequate ability to coordinate national defense and national emergency needs.

Mr. **Brown**. Arm's-length, as you expressed it, has been the case between some very large independent companies and the American company to date. And we have, in cooperation with the Defense Department, been able to make this work. As I say, that's the basis for my belief, that we can make it work.

Senator **Schmitt**. I know you're going to try, and we're all going to see that you try. We just have to be absolutely sure that having expanded the numbers of people involved in coordination that it will still work.

Mr. **Brown**. Yes, sir.

Senator **Schmitt**. How many arm's-length setups do you have right now?

Mr. **Brown**. There are about 1,500 independent companies with service in the United States today.

Senator **Schmitt**. Don't you see a relationship with them changing significantly under this consent decree?

Mr. **Brown**. No, sir, I don't. We will just have 22 more now.

Senator **Schmitt**. Twenty-two more.

Mr. **Brown**. Yes, sir.

Senator **Schmitt**. Big ones; 22 more big ones?

Mr. **Brown**. Well, the biggest one is about the same size as General Telephone.

The **Chairman**. Is that determined, that you're going to have 22, or is the option still there for——

Mr. **Brown**. The option is still there to combine them in different ways; that's correct. There may be less than that or more than that. And we, frankly, have not come to that conclusion there. There are a lot of factors, obviously, which bear on that.

Senator **Schmitt**. Mr. Brown, could you elaborate on a statement, which I believe was contained in your prepared text, that A.T. & T., Western Electric, and Bell Labs will provide, on a priority basis, the manufacturing, research, and development services needed by the local operating companies. And is it true that, in reality, the current situation provides another form of subsidy to these operating companies in that Bell Labs and Western Electric have been performing that research as part of the total A.T. & T. operation?

Mr. **Brown**. No, sir, I don't believe it's a subsidy in that sense. There is no free lunch with respect to R. & D. and manufacturing. The companies pay for R. & D. and manufacturing either through the price of the product or through what's called the license contract, which helps support the Bell Telephone Laboratories.

Now, what is referred to in this paragraph which you cited has to do with divestiture after assuring that the companies have enough technical capability to perform their part of the decree. Of course, these companies are Western Electric's major market. And after divestiture, you can be assured that Western Electric will work very hard to make sure that these companies have access to technology supplied by Western and the labs. The paragraph specifically referred to getting companies ready to do their part in the decree, and we are obligated to do that.

Senator **Schmitt**. A recent New York Times column discussed the impact of the settlement on Bell Labs specifically. One scientist indicated he was not concerned that the settlement means an end of Bell Labs, but he said he was "still not convinced that basic research would go on to the depth that it does now."

Would you comment on that statement and on the prospects for basic research and whether or not it will take a back seat to product-related or bottom-line applied research under the restructured A.T. & T.?

Mr. **Brown**. Basic research has been the root of Bell Laboratories' success, Senator Schmitt, and it will continue to be the root of it. We do not intend to skimp on it. We do intend to make sure that the laboratory operates in the fashion it has operated before, albeit with different funding. This is something we have as a basic tenet. There is no intention whatsoever to skimp on laboratory work.

Senator **Schmitt**. Do you believe that under this new system you can resist the pressure to become more applied and less basic? The Government hasn't been able to resist that through the years. Do you think in a large bureaucracy like A.T. & T. you will be able to?

Mr. **Brown**. It is our job to do so, Senator, and I believe we can. We fully understand, for example, that the invention of the transistor in the Bell Telephone Laboratories is the root of a great deal of technology today in the world, electronic technology.

Bell Laboratories is not affiliated with local telephone companies, which still exert the same sorts of effort to bring to being such things as the transistor and, in this case, apply it to not only communications technology but wider technology.

We have seven Nobel winners at the Bell Telephone Laboratories, and I haven't seen any of them resigning——

Senator **Schmitt**. But it is going to be a new environment.

Mr. **Brown**. Resigning because of this.

Senator **Schmitt**. And your Bell Labs has been able to, through the years, for a variety of reasons, invest in research that had no foreseeable payoff, and it was being conducted. And if there was a payoff, it was a decade or so down the road. That's unusual in a highly competitve environment, which we will start to enter now under the provisions of this proposed consent decree for any private sector corporation to make that kind of any investment in a long-term future. It's going to be tough.

You're going to be in competition with a whole bunch of big guys, not as big maybe as you are at this time, but ones who would like very much to become that big. And the pressure to go to short-term applied research is going to be very great. I just hope you're right.

Mr. BROWN. We are in competition with people a lot bigger than we will be, Senator. And I just have to assure you that we consider the Bell Telephone Laboratories the jewel of the Bell System, and we will not neglect it.

Senator SCHMITT. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

Let me ask you this, Mr. Brown, if one just takes the consent decree as it stands today—assume no legislation, because we don't have any legislation in effect today—in the absence of legislation, does your statement still hold, that you would anticipate local rates out into the future only, on the average, to be rising maybe a dollar a year?

Mr. BROWN. Yes, sir. Under the present conditions, under the present intention of regulators, under the present competitive condition, I expect over the next few years to accommodate the things I mentioned, that local rates will go up in the order of 8 to 10 percent.

Senator RIEGLE. And you're saying, with an average telephone bill across the country for local service of about $10, it's your estimate that even without additional legislation you would perceive a rate increase on the average of a dollar or less on that bill; is that right?

Mr. BROWN. I said a dollar a month, each year, increase.

Senator RIEGLE. That's right, a dollar a month on the $10 charge.

Mr. BROWN. Yes, sir. The first year, $11; second year, $12.

Senator RIEGLE. Right.

Now, I want to understand the basis of why you say that, in the absence of legislation. You made a reference to what was in the bill that would have dealt with this in a statutory way. But absent the legislation, what will insure that this will be what happens?

Mr. BROWN. The regulators' authority is not touched under this consent decree. And so, what was intended, what was expected, what is driven by the combination of inflation and competition and shortened lives of technology will be carried out in any event, and the consent decree does not touch it.

Senator RIEGLE. But I don't understand what you base your projection on that the costs might not rise more than that. Are you simply saying—you're saying that's your best estimate, but you're not giving any guarantee that that's the case, are you?

You're not saying that you're certain. You're not saying that there's an ironclad structure that will assure that that happens. You're saying that that's what you think will happen. Is that right?

Mr. **Brown**. I'm saying that this is under full control of the regulators today and will remain under control of the regulators. My estimate is based on what will happen over the ensuing 4 or 5 years, driven by these other matters. I cannot guarantee it, because we propose and regulators dispose.

Senator **Riegle**. But you're saying that the regulators, in your view, under the consent decree have sufficient authority to keep those rates rising only at those lower rates of increase and not at a much higher rate of increase?

Mr. **Brown**. Yes, sir, I did.

Senator **Riegle**. Let me send something down to you that you ought to take a look at. What I'm sending down to you is—I'm trying to get copies for my colleagues—this is a release by the Public Service Commission of Michigan. You may be familiar with the fact that they have been conducting a series of public meetings across the State of Michigan because of their high degree of concern about both the legislation and now, presumably, the consent decree, because it's their belief that rates are likely to shoot up at a very fast rate.

I would like to refer you to this document. And I have underlined and marked with an X the paragraph that I would like to draw your attention to. In it they say as follows—and this is the Michigan Public Service Commission in a public statement within the last few weeks:

> Certain estimates indicate that if the changes proposed by the FCC and the U.S. Senate were in effect today, present customers of Michigan Bell Telephone could expect to pay in excess of twice as much for local phone service as is presently the case. Customers of many of the independent telephone companies in the state are likely to experience increases greater than customers of Michigan Bell, or presumably then something more than the two times increase.

Well, this has set off an avalanche of concern in the State. I have received well over a hundred letters, and it's just starting because of this concern.

Can you comment specifically on the assertion by the Michigan Public Service Commission in this release as to your reaction to that paragraph and why, in your view then, this is not an accurate statement?

Mr. **Brown**. In the first instance, I was referring to the consent decree itself, which has little, if anything, to do with increased rates, except for the yellow page matter of which we talked.

Secondly, I really do not understand in this paragraph what changes proposed by the FCC and the U.S. Senate would have this kind of an effect.

And I would repeat that the changes in rates which have been in effect and coming in recent years are driven by inflation and driven by requirements due to shortened lives of equipment and due to the competitive situation and fully under the control of the regulators.

I'm sorry I don't know on what basis the Commission comes up with this answer, nor do I know what features of the U.S. Senate bill would cause this. I'm sorry I can't respond to it, because I don't understand what the basis is.

Senator **Riegle**. Well, my time is up. Assuming we have one more go-round here, I would like to pursue this a little bit further.

The **Chairman**. Don, let me emphasize again one thing. The FCC today has the power to eliminate these subsidies. I don't know what ideas may be boiling around below the surface of the FCC pot. Maybe your Commissioner has some access to some options that are being suggested.

We wrote into S. 898 a statutory prohibition on that happening. If S. 898 doesn't pass, and whether or not the consent decree goes through, the FCC at any time could abolish those subsidies.

Senator **Riegle**. If you will yield, I think that's a critical point. And that's what I'd like to nail down here, because the question is do we need legislation now to come in and address this issue precisely that would then dovetail with the consent decree to make sure that we have that guarantee so we don't find ourselves with some rapid administrative decision by the FCC that would see a doubling or tripling of rates.

The **Chairman**. We need the legislation whether or not the consent decree was ever entered into. It's now pretty much up to the House, because we sent over a provision that will guarantee that those rates will not go up excessively. But it's in S. 898. We've got to have at least that part of the bill back.

Senator **Riegle**. If I may, I think it's very important though that, if that is so, we hear it from Mr. Brown himself as well. I'm wondering if his view squares with yours? That, in fact, we've got to have that legislative structure and statutory structure to make sure that his prediction comes true and is likely to come true.

Mr. **Brown**. Senator, I think the FCC and the other regulators need to be and are mindful of what is going on in the telecommunications industry. And it will not really be feasible to continue irrational kinds of pricing procedures in the face of competition.

Let me suggest this. If access charges, which will under this decree be the substitute for the existing mechanism for subsidizing local rates—if those access charges are exceptionally high—as a matter of fact, if they are not reduced, the very simple economic and technological occurrence will be bound to happen.

And that is technology will bypass the local plant. I'm talking about antennas to rooftops, I'm talking about cables or microwave or cellular radio, which will go directly to customers and bypass the local plant if it costs too much to connect through it.

These technological conditions are not going to wait for anything. There is plenty of competition in the inter-city business, all of this, competitors will move directly into the lowest-cost means of reaching the customers.

I know that both the FCC and the local regulators are fully aware that an irrational rate structure like this cannot be maintained forever under a competitive condition. It is one of the prices of competition and free choice in America, and I believe that it will be recognized over a period of time and cannot be legislated around.

Senator **Riegle**. I thank the chairman for raising that point, because I think we've got to nail down precisely whether or not we need this legislative structure. And it seems to me that we do.

Senator **Goldwater**. Can I follow with one point on that?

The **Chairman**. Senator Danforth is next. Will you yield to Barry a second?

Senator DANFORTH. Yes, sir.

Senator GOLDWATER. I would ask your opinion, only. Isn't it possible that we are close to the day when land lines will no longer exist and all transmissions will be done by microwave, satellite, or cable?

Mr. BROWN. I believe the problem there is the resource itself, and that is the number of frequencies which are available for this. I believe because of that that copper wires will be a resource that will be used substantially for many years. But the so-called cream-skimming of the local plant has started now with respect to satellites directly to rooftop antennas. It will continue, and from the standpoint of cellular types of radio transmission, the higher the artificial subsidy or the artificial or irrational rate structure, the more this will become economically feasible for all competitors.

Senator GOLDWATER. Thank you.

The CHAIRMAN. Senator Danforth?

Senator DANFORTH. Mr. Brown, I would like to ask you to tell the committee what changes of directions you foresee for A.T. & T. as a result of the modified decree. The old 1956 decree substantially curtailed the activities of A.T. & T. The modified decree removes some of those impediments to the types of business that the company could be in. Looking down the road between now and the end of the century, what do you see for A.T. & T. as a result of the modification? What excites you about the new decree?

Mr. BROWN. Fundamentally, our technology has been inhibited by the 1956 decree. We could not follow our technology where it led. Thus, these inhibitions kept us from such things as we have now proposed known as ACS, advanced communication service, as one example. We have in the works and we'll be able to move, using combinations of data processing and communications techniques, a system which will permit computers which speak different languages to converse directly with one another, as an example. It will permit companies with different computer systems within their organization to have these systems talk to one another, and it will permit companies whose suppliers use different computer systems to talk directly with these companies and their computer systems.

It is a marvelous breakthrough with respect to the combination of data processing and telecommunications techniques, and we're excited about it. The technology has driven these two techniques together, and the artificial restriction of not being able to enter nonregulated businesses was severely inhibiting us. This is merely one example.

Senator DANFORTH. Now, if you were not in—in your present position not connected with A.T. & T., what other types of businesses, what potential competitors should be concerned about the new directions of A.T. & T?

Mr. BROWN. Well, I guess I hadn't given too much thought to that. Competitors don't seem to need my sympathy or concern, Senator, and I really hadn't thought very much about it.

Senator DANFORTH. Should newspapers feel concerned?

Mr. BROWN. The problem that the newspapers saw is completely eliminated by this divestiture. They were concerned about the local companies having the yellow pages and using the wires to transmit the information. That's gone. I don't see why they would be worried.

Senator DANFORTH. Do you see, as far as a consumer is concerned, an alternative to going out to the front stoop and picking up the paper in the morning? Will there be an additional way of getting information into the home?

Mr. BROWN. I imagine there would be lots of alternative ways. As a matter of fact, I think satellites, as now used by newspapers, offer this alternate way already. There is enough satellite capacity up there now to transmit all the daily newspapers in the United States in an hour, and we're not even in that business of transmitting by satellite direct to rooftop antennas. So IBM, I.T. & T., Hughes, RCA, the Japanese, are going to open up this field in ways which we cannot imagine yet.

Senator DANFORTH. Do you look for a major change over the next decade or so of the type of business that A.T. & T. is involved in?

Mr. BROWN. No, sir. I would say we intend to stick to our last, which is telecommunications. We have no desire to get into—nor expertise—to get into other businesses. But we really do not—hope we will not be inhibited by artificial technological restrictions. But telecommunications is our business and we expect to stay in related fields.

Senator DANFORTH. Some would say that the telephone company is so large, its resources are so great, and its research capacity is so sophisticated, that other companies with which it will be competing in the future and with which is it not really competing today should be very concerned about this new entry into their market or their potential market. Is that a reasonable concern, in your view?

Mr. BROWN. Senator, one of the reasons I've taken these excruciating steps is to eliminate this idea that we're so big nobody can compete with us. We have divested two-thirds of our assets. We are in the long distance business, which is intensely competitive. There are hundreds of people in the business. I think the idea that we are dominating and should be feared because of that is an outmoded idea which really needs to be looked at in the light of what we have done here. I don't know what price we would have to pay in order to get rid of this idea of dominance than the price we have already paid.

The CHAIRMAN. In response to one of the earlier questions about the subsidy in long distance rates, you said competition will inevitably either circumvent the ratemakers or force the ratemakers to lower their subsidy. Do I phrase it correctly?

Mr. BROWN. Yes, sir.

The CHAIRMAN. Then you mentioned the rooftop antennas. I know what you're talking about. You're talking about communication directly from point to satellite to rooftop, not using wires at all, and therefore avoiding the present system of access.

Mr. BROWN. Yes, sir.

The CHAIRMAN. What happens, however, if we want to continue the subsidy and we decide—and we have the power to do so, that we're simply going to charge a spectrum fee for the use of the air and continue the subsidy?

Mr. BROWN. Yes, sir. I think that's one possibility.

The CHAIRMAN. So the fact that competition might drive the prices down doesn't mean that we cannot levy on all the competitors a uniform spectrum fee to continue subsidy of local rates?

Mr. BROWN. Yes, sir. I'm sure that's a possibility.

The CHAIRMAN. I don't know if the FCC has the power to impose such a fee, but clearly the Federal Government has the power to do it if it chooses to. We might have to delegate it to the FCC or otherwise, but there's no question that we have that power. The local companies are going to be left with basically nothing but their lines and their interconnectors; is that true?

Mr. BROWN. I'm sorry——

The CHAIRMAN. Local companies left with their lines and interconnection devices.

Mr. BROWN. This is $80 billion worth of very sophisticated kinds of communications gear which has been modernized very carefully over the years. Each one of these companies have modern electronic switching systems, systems which permit you to get more and more gain out of one pair of wires, systems which are digital in nature which go between various parts of town. These are the companies that have provided the best telephone system in the world and they are not anachronistic in anyway.

The CHAIRMAN. I understand that, but they're not going to be allowed to get into any other businesses. They can't get into printing classified ads on cable television. They're not going to be providing the telephone in your home. What is it that you envision in the future that they can go into that will one day keep them from becoming the railroads of the communications industry?

Mr. BROWN. Well, let me outline what I think will prevent that. First of all, as I mentioned, they are modern companies. We have put in my lifetime in this business 20, 25 percent of a huge construction program into modernizing these companies and so they are not in anyway anachronistic from that standpoint. Second, they have strong management. The management of the telephone business, I think, is generally recognized to be good and strong. These are the same people who have been doing this over the years. Third, we intend to spin these companies off in good balance sheet conditions and so we're not putting them in any sort of financial jeopardy from the standpoint of the spin-off conditions. Fourth, they have a wide market. There is no doubt but what these are the people, these are the companies supplying a vital telecommunications service which is obviously needed by the whole community. Fifth, this market is growing. It's not contracting, as some utility service are, but it's growing. Sixth, they have a great opportunity from the standpoint of so-called usage sensitive pricing, whereas usage increases, the prices are appropriate to the individual who uses it.

And lastly, they are the gateway. They are the gateway to the information age, if you will. They are the ones who have the facilities, the circuits, the capabilities to bring incoming services from the many competitors in the inter city business to the subscribers and to take these services out. And so they are not, by any means, a railroad in the sense that they have declining economies or are in bad financial shape or losing their markets.

The **Chairman**. You don't think they're in the same position that you described in response to Senator Goldwater's question, then, about competition driving prices down so far that if the subsidy doesn't come down, the competition will find other ways around? You don't picture rooftop antennas at home receiving telephone signals and the wires becoming obsolete?

Mr. **Brown**. What I was trying to say, at least, was I think the regulators understand that you cannot have a free lunch in the economic sense. And if the prices are artificially kept too high, somebody will go around them. And I think this is what is causing the recognition that irrational pricing cannot last forever.

The **Chairman**. Senator Schmitt?

Senator **Schmitt**. Thank you, Mr. Chairman.

Mr. Brown, I hope that you are right that the regulators understand, but regulators are political people and the pressure, political pressure, on these regulators to keep rates down, to keep rates from rising independent of need is very, very high. We've seen that in the *Mountain Bell* case out in New Mexico. I think you're going to see it all over the country.

The one thing you left out of that very interesting, and I think accurate list of assets and potential assets of the operating companies is that on the negative side of the sheet is politics. Whether or not legitimate, deserved rate increases, when they are required, can be achieved. And if they can't, what is the potential to drive costs down through new technologies or more efficient service in order to live with a political environment in which these rates are going to be set?

Mr. **Brown**. I have two thoughts in connection with that, Senator Schmitt. First of all, this is no change from the existing situation. There is no way that—some magic way that the company under the present condition can get money, if the regulatory commissions do not recognize what their duty is with respect to that. And I think by and large over the years with some exceptions, regulators have responded to what legally and morally they should do with respect to rates.

Senator **Schmitt**. How many exceptions, though, can you stand, before an operating company goes belly up or the service begins to decline?

Mr. **Brown**. Well, this brings me to the second point I was going to make. If there's any one thing that regulators dislike and are under intense pressure about more than raising rates, it's poor service, and I don't think there are very many, if any, regulators in this country, given the choice of having a deteriorating service situation in something as significant as telephone service, would take what might be considered a politically easy route out. And these conditions exist today. Each one of the 48 States and the District of Columbia are on their own from the standpoint of the relationship to rates of return and service quality.

Sure, we have made up the difference in some cases from one State to another, but that's generally a temporary situation. And I think the regulators, understanding what it is that is required to have healthy telephone service, will respond.

Senator **Schmitt**. I hope you're right. I know it's a situation that exists today, but it is the environment in which we must view the implications of a proposed consent decree on any legislation that may pass the Congress.

Mr. **Brown**. Yes, sir, it's a regulatory environment which sometimes offers political solutions to economic problems. I'm painfully aware of this.

Senator **Schmitt**. Within the total area of utilities, the phones, electric, gas, and other services, there's a tremendous amount of skepticism out there among the public. I certainly see it in New Mexico that these rate increases are deserved. It's a skepticism born of inflation and of other problems that New Mexicans and Americans in general are having in paying their bills. And so I'm hopeful that we'll get control of the overall economic situation, so that some of those other difficulties will begin to disappear. But if it continues, in many States, many areas, there is going to be a very, very difficult time in insuring that there is a rate of return on the investment of these local operating companies that will insure not only quality service, but their economic viability as well.

Mr. **Brown**. I recognize that, and I think it's mitigated in the telephone situation by virtue of the fact that we have held telephone rates down, and we've held them down below the rate of inflation for many, many years. I think the telephone service in this country now is a real bargain. And I believe that most people feel the same way, in accordance with the surveys we take. So I don't think in the telephone case situation it's as serious as it is in some other cases, where the rates have had to escalate sharply, even past the rate of inflation.

Senator **Schmitt**. That's an impressive record. I don't deny that. And we all, I think, admire the Bell System for having accomplished it, but it's still another rate. It's still another bill aggregated in the household with all other bills, and when they see a rate increase, even if it's less than the rate of inflation, it's an increase, and politically, it is lumped in. It's lumped in with all the other rate increases that the American public is being subjected to today.

Mr. **Brown**. I'd think we'd be very pleased to dispense with the regulation, if that's a help.

Senator **Schmitt**. Thank you, Mr. Chairman.

The **Chairman**. Senator Riegle?

Senator **Riegle**. The question is, if we did, and I understand the jocular tone in which you make that comment. What are the rates going to look like if that happens, and that's a deadly serious issue. I just want to stress again——

Mr. **Brown**. I'm sorry, but I have to say, sir, we have not been predatory in any way. And the results of the job we have done, I think stand on their own feet.

Senator **Riegle**. I think the record of service in maintaining a relatively low cost service is really an exceptional record. If we compare what we've accomplished in this country versus other countries, it really is an extraordinary accomplishment, and I applaud that.

Mr. **Brown**. Thank you, sir.

Senator **Riegle**. I feel that strongly. We don't want to lose it. That's the issue now. Are we about to move into a new era, where suddenly local rates may start to skyrocket? That's really, I think, the basic question here. As I go through our earlier exchanges, it seems to me there is a basis for arguing that maybe that won't happen, but there isn't any ironclad guarantee that that won't happen. I want to make sure that we're not getting into a "Catch-22," where one says, "Look, there are going to be additional costs, and that's just the normal course of business. Technology is changing, and as we go through this divestiture, there will continue to be regulatory control, but if costs get out of line, and if the cross-subsidization isn't adequate, it's conceivable that the rates could shoot up, and it wouldn't be anybody's fault." Well, I don't think that's an acceptable situation for us to be in, because we are now in a framework which prevents this from happening. I think in devising a new framework which provides other benefits in terms of meeting foreign competition, and so forth, we've got to do it in a way that doesn't allow these local rates to skyrocket.

I don't think we've nailed that down yet, but we're in that situation. You can provide part of that answer—Mr. Baxter will have to address it as well. When you made the point earlier that on the average, the monthly local service cost is $10 a month, and you would anticipate under these changes, local service rates to go up not more than $1 a month, on top of that $10 fee——

Mr. BROWN. Each.

Senator RIEGLE. It's something less than 10 percent over the next few years.

Mr. BROWN. Each year.

Senator RIEGLE. Each year for the next few years.

Mr. BROWN. Yes, sir.

Senator RIEGLE. Then you're portraying a picture here that's quite different than the one that many others have, or the concern that's been expressed in the fact that it might shoot up much higher than this.

So my question to you is this: In our bill, on page 65, when we set up the Joint Board, and then over again on pages 70 and 71, we nail down what the precise authorities would be under the Joint Board, to make sure that rates would not exceed 110 percent of the national average for comparable service. We actually built in a way to safeguard the rate of increase in the future on local rates.

Can you support this? Can you support the kind of a legislative step that would insert this into the deregulation process in order to insure that these costs did not spiral out of control here?

Mr. BROWN. Sir, unless I'm mistaken, that provision applies to rural rates; is that not so?

Senator RIEGLE. Yes, it does. It does in this case. It applies to rural rates. Let's take up that part first.

Mr. BROWN. I don't have any problem in agreeing with this sort of a provision. The regulators now have this ability, is all I've said. I've said before, they have the ability to do this, and they are the ones that are responsible for not only controlling rates but making sure the telephone companies are healthy. They have the ability to do this now, and they have done it.

Senator RIEGLE. So you would be willing to support that kind of a provision as it relates to rural rates; is that my understanding?

Mr. BROWN. I would be willing to support the provision which now is in the regulatory procedures; this can happen.

Senator RIEGLE. That's the problem, because if we only do that, we're in a situation where these new costs are going to be coming online through rapid depreciation and other items. The whole question of what will be the cross-subsidization factor here, could, in fact, create a cross-burden that would give the local public service commissions the excuse to say, "Well, we're stuck. The costs are there. The rates are going to have to jump much higher than the dollar per month that you're talking." It might, in fact, conceivably be faced with having to double or triple rates within a period of 2 years, depending upon their cost structure.

So it seems to me that what this legislative step is designed to do, whether we're talking about rural or rural plus everybody else, is to create a framework in the law, where we put a cap on how much these rates can rise in the period of years just ahead. And my question is, Are you willing to accept that as a legal framework that we would try to work out here, and try to put into the law in such a way that it would provide that protection against skyrocketing local rates, and at the same time give you the other things that you need to compete more effectively?

Mr. BROWN. I don't have any real concern with that as it relates to rural rates. I think it might be a legislative hindrance to the process of regulation in providing good telephone service, were there to be some flat prohibition against the regulators doing what was necessary to provide the companies with enough money to do their job. I think conditions continue to change, and it might be unwise for the legislature to tie the legislators' hands to the point where they couldn't do what was necessary.

Senator RIEGLE. I'll just finish by saying this. I think we're going to have a revolt on our hands from citizens across this country, and particularly the elderly, if they're faced with a situation where their phone rates could conceivably double or triple over a period of the next few years—I know you're saying it doesn't have to happen, but you are not, in turn, saying that we have a foolproof system to prevent it from happening. In fact, depending upon what happens, it could conceivably happen in some places, and I think we've got to have a foolproof mechanism that prevents that from happening. I think it's in your interests, I think it's in the country's interests, and I think it's in the interests of phone users, that they not experience that kind of rapid increase in local service rates.

Mr. BROWN. Well, sure, if there were a foolproof method of preventing inflation from going up at excessive rates, I would be inclined to agree with you, but you can't legislate against that.

Senator RIEGLE. Here's what I'm saying. You're saying your own estimates are that the rates on the average shouldn't have to go up more than $1 a month.

Mr. BROWN. That's right.

Senator RIEGLE. Out over the next few years, which would be a rate of less than 10 percent increase. And I'm saying, if your technical observation to us is that they don't have to go up more than that, I'm saying, let's sock it in. Let's have a structure that sees to it that we stay within those bounds. And I don't know why that would be objectionable.

Mr. **Brown**. I don't think you can lock in inflation, is my point. And these estimates are based on inflationary estimates.

Senator **Riegle**. Well, I think the problem goes beyond just the issue of inflation. What we're looking for is a windfall change in circumstances here which would drive the rates up at an extraordinarily rapid rate, because the cross-subsidization through the long lines, and so forth, would not be managed in situations that would keep the local rates advancing at much lower rate of increase here.

Mr. **Brown**. Absent inflation, I would not have a whole lot of trouble with that sort of issue. And I say, absent inflation.

Senator **Riegle**. I understand, but I think that's a very important point.

Mr. **Brown**. I think that's a very important point.

The **Chairman**. To avoid any confusion, Don cited a 110-percent figure. It's the same figure I called 10 percent. I discovered it confused people in the past; $10 a month, and we say in the bill that the rates cannot go up more than 110 percent of the national average. The bill presumes that $10 is the 100 percent. And I used that figure the first time, and people thought that meant it was going to go up 100 percent. He and I are talking about the same thing, Jack.

Senator **Danforth**. No questions.

The **Chairman**. Jack?

Senator **Schmitt**. I have several other questions, Mr. Chairman, but I know you believe, as I do, that we must proceed, so I will ask them for the record.

The **Chairman**. Mr. Riegle?

Senator **Riegle**. Mr. Chairman, I'd ask that the statement of the Michigan Public Service Commission, which I gave to Mr. Brown, will be made a part of the record.

[The information follows:]

STATEMENT OF ERIC J. SCHNEIDEWIND, CHAIRMAN, MICHIGAN PUBLIC SERVICE COMMISSION

Chairman Wirth and members of the Subcommittee on Telecommunications, Consumer Protection and Finance, I am grateful for the chance to testify before this Committee regarding H.R. 5158 and the proposed settlement of the antitrust suit against AT&T.

I also bring you greetings on behalf of the Governor of Michigan, William G. Milliken. Governor Milliken is deeply concerned that many of the citizens of Michigan may be priced out of the telecommunications market if S. 898 or the proposed AT&T antitrust settlement are adopted in their current form. In order to acquaint you with his views, Governor Milliken asked me to include his personal statement in my formal testimony.

"The House Subcommittee on Telecommunications, Consumer Protection and Finance is considering legislation and an antitrust settlement agreement which will completely change the telecommunications industry.

"Senate Bill 898 and H.R. 5158, as well as the proposed AT&T settlement agreement, are intended to achieve competition in the provision of telephone equipment and long distance services. I share the belief that competition in these areas may help to assure better telephone service at a lower cost than would be possible under the current system of regulation.

"While I believe that competition in the telecommunications field may offer long-range benefits, I am deeply concerned that both S. 898 and the proposed AT&T antitrust settlement may result in substantial short-term cost increases for the Michigan citizens who can least afford them.

"It is too soon to assess the impact of H.R. 5158; however, I believe that both the AT&T settlement agreement and S. 898, in conjunction with pending action of the Federal Communications Commission, could produce a doubling or even tripling of basic telephone service rates. This basic telephone service is a necessity for many Michigan citizens who must have the ability to communicate rapidly for health services, fire protection and police protection. Many of our senior citizens and unemployed citizens could face increases in their telephone costs of over $150 a year. At such rates, these citizens might have to drop telephone service and lose their link with vitally needed services.

"I urge the members of the House Subcommittee on Telecommunications, Consumer Protection and Finance to use every means at their disposal to work for a national regulatory framework which will produce competition and continue to assure basic telephone service at rates that can be afforded by all citizens."

I hope to bring to your Committee the concerns and perspective of a state official who will have to explain to the consuming public the reasons for telecommunications deregulation and any adverse impacts that such deregulation may cause to these consumers. For, after all, state public utility commissioners are the ones who are going to have to make the regulated network technically compatible with the new deregulated telecommunications system on the local level and repond to customer complaints. State regulators will have to grant rate increases caused by deregulation and state regulators will have to assure the citizens of our states that they will continue to receive telecommunications services that are both reliable and affordable.

The perspective that I bring to these hearings may, in fact, be unique even for a state regulator because the Michigan Public Service Commission has just completed a series of 7 hearings throughout our state which afforded the citizens of Michigan an opportunity to learn about the impact of both S. 898 and the proposed settlement of the antitrust suit against AT&T. These hearings extended over the period of January 11 through January 28 and took the Michigan Public Service Commission from the tip of the Upper Peninsula in Houghton, Michigan down to the Detroit Metropolitan Area. At these hearings, Michigan Public Service Commission staff explained the potential impact of S. 898 and the antitrust settlement on the availability and price of basic telephone service.

I have included in my remarks below, a chart which breaks down in detail the cost impact information which was presented at these hearings. It should be borne in mind that in regard to S. 898 the cost impact information includes recent actions of the FCC. These cost estimates do not include the impact of inflation. Time did not permit a similar evaluation to be made concerning the potential impact of H.R. 5158. However, it is my preliminary evaluation that H.R. 5158 will cause far less adverse impact on basic telephone service costs than either the AT&T settlement or S. 898.

ESTIMATED EFFECTS OF S. 898 IN CONJUNCTION WITH PENDING FCC ACTIONS AND A.T. & T. ANTITRUST SETTLEMENT ON MICHIGAN BELL TELEPHONE CO. RESIDENTIAL LOCAL SERVICE RATES PER MAIN STATION PER MONTH

	S. 898 with FCC actions	A.T. & T. settlement
1. Depreciation issues:		
a. Rates comparable to competitors	$2.93	NA
b. Accelerated depreciation on new plant additions	.40	
2. Change separations procedures and deregulate embedded customer premises equipment:		
a. Loss in intrastate toll revenue	1.86	$1.86
b. Loss in interstate toll revenue	2.53	2.53
3. Yellow pages revenue	2.10	2.10
4. Expense station connection costs and deregulate new installations	1.47	1.47
5. Loss of customer premises equipment: Local rates beyond the separations effect	1.27	1.27
Total estimated increase in local rates per main per month	12.56	9.23
Present monthly local service rate (residential)	9.74	9.74
Percentage increase in rates anticipated from implementation of S. 898 and FCC actions	[1] 129	[2] 98

[1] Does not include inflation.

[2] Does not include numerous other adverse cost implications which cannot be estimated at this time, such as increased BOC cost of capital, loss of EAS, BOC loss of interexchange, BOC losses due to transfer of assets to A.T. & T., etc.

Having completed our series of 7 hearings, it is safe to say that the citizens of Michigan have three overwhelming concerns regarding any proposed deregulation of the Telecommunications system. One major concern is that they continue to be assured that someone or some company will provide them with a basic telephone and service on that telephone if no private entity wishes to serve their geographic area. This concern was expressed most frequently in rural areas, such as portions of the Upper Peninsula and Michigan's northern Lower Peninsula. The citizens of these areas know that a strict economic analysis would seldom, if ever, justify location of service personnel either permanently or temporarily in their area. Yet, it is obvious that citizens of sparsely populated rural areas are often most heavily dependent upon reliable and adequate telephone service. We completed several hearings in Michigan's Upper Penisula at time when severe snow storms had swept the area. Many of the secondary roads are often not cleared of snow for up to a week after a major storm. When natural disaster strikes, the telephone is often the only link people of this area have with essential health and safety services. There were many stories in the news regarding people who needed health services, such as birth of infants, who were only able to obtain this emergency medical service by using the telephone. Until now, regulated utilities have been required to install and service the basic telephone which enables the people of these regions to maintain their contact with the outside world. Both the Public Service Commissioners and the people of these regions are fearful that a deregulated terminal equipment market would not provide service to these areas because there is not enough business to warrant local maintenance forces.

A second, and equally serious, concern of all the citizens who attended our hearings was that telephone service must remain affordable to all segments of our population. Numerous senior citizens groups, unemployed (here it should be noted that Michigan has the highest unemployment level in the nation) and representatives of low-income groups indicated that they would not be able to afford telephone service at the doubled or tripled rates which were likely to result in the event of deregulation along the lines contemplated by S. 898 or the AT&T settlement agreement. These citizens emphasized that they were able to have telephone service currently because the existing rate structure made that service affordable to them. They also indicated that at doubled or tripled rate levels, telephone service would no longer be affordable to them. Senior citizens were particularly fearful that loss of telephone service would deprive them of the ability to quickly contact health or police protection services. Any loss in customers results in continued higher costs for the remaining customers.

Finally, and perhaps surprisingly, most of the citizens appearing at our hearings were in favor of competition in the telecommunications business if telecommunications service could continue to be available to all who required it and be available at an affordable price. The people of Michigan do have faith in the competitive system and believe that over a period of time a truly competitive environment could bring better service at lower prices, but they are also mindful of the impact of airline deregulation which has often left rural communities and many urban communities with very little, or very expensive, service.

In summary, I believe that the people of Michigan have enunciated four goals that they feel are minimum requirements of a new telecommunications regulatory framework:

1. Citizens must be assured that some entity will be required by law to sell and install at least basic telephone instruments and associated wiring in their home if unregulated entities do not provide that service.
2. Citizens must be assured that some regulated entity will be required to repair and maintain the telephone in their home if unregulated entities are not available to serve that need.
3. Basic telephone service must not be increased radically in price so as to make that service unaffordable to a large segment of the population.
4. Consistent with these goals, and to the extent competition exists, deregulation of certain telecommunications equipment and services may provide benefits in the form of better service at a lower price.

I believe that six principles, if adopted in the AT&T settlement or in any legislation passed by Congress, would secure competition in the telecommunications industry and assure basic telephone service at an affordable price. These six principles are as follows:

1. State regulators must be permitted to require an exchange carrier to provide basic telephone equipment and service on that equipment if unregulated entities are not providing such service or equipment.
2. The Yellow Pages operation and the revenues from that operation must be retained by exchange carriers.
3. State regulators must be permitted to decide the disposition of embedded customer premises equipment and station connections.

4. State regulators must be assured that any assets transferred from exchange carriers to a deregulated entity or to AT&T will be priced at fair market value.

5. State regulators must be permitted to set access charges for exchange carriers. In the alternative, an administratively final Joint Board with majority state membership may set access charges. In either case, revenues received from access charges must at the outset equal revenues currently received from the separations and settlements process. In the longer term, market forces and the ability of carriers to bypass the local network may force adjustments in access charges. However, a transition to this situation is paramount if universal service is to be continued and if the telephone network as it presently exists is to be able to survive.

6. Regulators must be allowed authority to set depreciation rates and methodologies for assets that they continue to regulate. Competitive market forces should be considered. But as long as certain services continue to be regulated because of lack of competition or dominance of a carrier in the provision of that service, regulators must be given the authority to determine the acceptability of this significant portion of a carrier in the provision of that service, regulators must be given the authority to determine the acceptability of this significant portion of a carrier's operating costs.

These six criteria would enable state regulators to assure reliable basic service to all customers and to assure that that service is provided at a reasonable price.

If we take the six criteria detailed above, the chart set forth below makes it apparent that S. 898 meets none of these criteria, the proposed AT&T settlement clearly meets only one of these criteria, and H.R. 5158 may meet several of the criteria.

POSITION OF S. 898, H.R. 5158, AND DOJ SETTLEMENT ON CRITERIA NECESSARY TO ASSURE RELIABLE AND AFFORDABLE BASIC TELEPHONE SERVICE

	S. 898	DOJ settlement	H.R. 5158
1. Regulators able to require exchange carrier to service and supply basic equipment as a last resort.	No	No	Partly. Exchange carriers must provide CPE tariffed within 2 years of enactment until fully depreciated and offer inside wiring for 5 years unless extended by the FCC.
2. Allow exchange carriers to keep yellow pages.......	No	No	No.
3. State regulators decide how to dispose of embedded CPE.	No	?	Yes.
4. Exchange carriers receive fair market value for assets transferred to A.T. & T.	No	?	Yes.
5. State regulators empowered to set access charges and exchange carriers receive revenue equivalent to current separations and settlement process.	No	?	No. FCC empowered to assess surcharges on access charges for a national telecommunications fund which would be allocated to local service, but not necessarily at current levels of funding.
6. Regulators empowered to set depreciation rates and methodologies for assets of carriers utilized to provide regulated services.	No	Yes	Section not written.

From the standpoint of a state regulator, it is clear that H.R. 5158 comes closer than S. 898 or the proposed AT&T settlement to meeting the criteria that I believe are necessary to ensure reliable and reasonably priced basic telephone service in a competitive environment. Yet, I would be remiss in my duty to the citizens of Michigan if I did not indicate that H.R. 5158 must be amended if we are to assure that basic telephone service will be available to all at a reasonable price. I urge that H.R. 5158 contain specific provisions to assure that state regulators will be able to set depreciation rates for the assets of the carriers which they continue to regulate. I urge that H.R. 5158 allow exchange carriers to keep Yellow Pages. I urge that H.R. 5158 also be amended to specifically enable state regulators to set the charges for access to the local exchange or that exchange carriers be guaranteed revenues equal to those provided by current separation and settlement procedures. And, finally, I urge that H.R. 5158 be amended to provide state regulators with the ability to order regulated carriers to provide basic residential telephone equipment and service on that equipment if market forces do not act to provide an area with service or sales of basic residential telephone equipment.

With these four amendments, H.R. 5158 would provide state regulators with the tools they need to assure that each of the citizens of their state have access to basic telephone service which is reliable, reasonably priced and provided in a competitive environment.

NOTICE OF OPPORTUNITY FOR PUBLIC COMMENT

The United States Congress and the Federal Communications Commission are currently each pursuing a significant restructuring of the communications industry in this nation. The stated purpose of these activities is to facilitate competition in the provision of communications services and equipment resulting from technological advances. It is possible that a restructuring may result in charges for basic local telephone service approximately double existing rates.

The Michigan Public Service Commission will be present to provide information on these Federal activities. Members of the public, utilities, business, consumer, and trade organizations, and any other interested parties are hereby, invited to appear, discuss and comment on the Federal activities.

These proceedings shall be in the nature of a legislative inquiry rather than a contested case. Persons appearing may be subject to questioning by the Commission, the Commission staff, or the presiding officer. Whenever possible, a written copy of the statement being presented should be submitted to the Commission at the time of the session. Oral comments may be limited by the presiding officer in order to afford all parties an opportunity to be heard. Written comments may also be filed with the Commission's offices, 6545 Mercantile Way, Lansing, Michigan 48910.

SUMMARY—DEREGULATION ACTIONS OF U.S. CONGRESS AND FEDERAL COMMUNICATIONS COMMISSION

On October 7, 1981, the United States Senate by a 90-4 vote passed Senate Bill 898, the "Telecommunications Competition and Deregulation Act of 1981." Action on this bill or a similar measure is pending in the United States House of Representatives. A Senate Committee analysis states that the bill attempts to promote competition in the communications industry by deregulating much of the industry and restructuring the Bell system. The analysis projects that in so doing, the proposed bill could significantly increase the rates to be charged for basic local telephone service, perhaps by 100 percent. The following provisions of the bill could cause these increases:

1. The Federal Communications Commission (FCC) would assume authority over intrastate long-distance telephone service presently regulated by States.
2. The present telephone industry mechanism for support of basic telecommunication services would be replaced within two years by the FCC. Although the FCC has the authority to assess surcharges on toll carriers to assure that no company's rates exceed 110 percent of the national average for comparable service, there is no statutory limit as to how much the average rate itself may increase due to provisions of this Act.
3. The regulatory authority over approval of depreciation practices utilized by telephone companies would be substantially reduced.
4. Profits derived from yellow pages advertising would not be available to reduce local service rates after four years.
5. Rates charges for leasing telephone sets or other terminal equipment or wiring inside a customer's premises, would not be reviewed by regulatory agencies and thus will be deregulated after a specified transition period.

The Federal Communications Commission (FCC) is pursuing steps similar to certain provisions contained in the Senate bill which, if implemented, could result in local telephone rate increases regardless of whether the Senate bill is enacted. Specifically, the FCC has ordered accounting changes relating to depreciation and the installation of terminal equipment and inside wiring, has ordered the deregulation of new terminal equipment leased after January 1, 1983, and is holding hearings regarding proposed amendement to the present mechanisms utilized to support basic telecommunications services. Passage of the Senate bill, however, could not only negate many court challenges being made to the authority of the FCC to pursue the changes it is making, but the Senate bill would provide for additional actions resulting in further local service rate increases.

Certain estimates indicate that if changes proposed by the FCC and the United States Senate were in effect today, present customers of Michigan Bell Telephone Company could expect to pay in excess of twice as much for local telephone service as is presently the case. Customers of many of the independent telephone companies in the State are likely to experience increases greater than customers of Michigan Bell.

Summaries of the federal activities are available upon request after January 4, 1982, from the Commission offices, 6545 Mercantile Way, Lansing, Michigan 48910, (517) 373-3265; Marquette County Clerk's office, Old Courthouse, Marquette, MI 48955; City County Building, Room 706, Detroit, MI; Grand Traverse County Clerk's office, 400 Boardman Avenue, Traverse City, MI 49684; Houghton County Clerk's office, County Courthouse, Houghton, MI 49931; Genesee County Clerk's office, County Courthouse, Flint, MI 48502; Kalamazoo County Clerk's office, County Courthouse, Kalamazoo, MI 49003.

Jurisdiction in this matter is pursuant to 1909 PA 300, MCLA 462.2 et seq.; 1919 PA 419, MCLA 460.51 et seq.; 1939 PA 3, MCLA 460.1 et seq.; and such other statutes as may be applicable.

The CHAIRMAN. Thank you, Mr. Brown. Good luck down at the Judiciary Committee

Mr. BROWN. Thank you, sir. I have my lawyer down there.

[The statement follows:]

STATEMENT OF CHARLES L. BROWN, CHAIRMAN OF THE BOARD, AMERICAN TELEPHONE & TELEGRAPH CO.

My name is Charles L. Brown. I am Chairman of the Board of the American Telephone and Telegraph Company.

I welcome the opportunity to appear before this Committee to discuss the agreement reached between the U.S. Department of Justice and AT&T which results in a modification of the 1956 Consent Decree and the impact that agreement has on the goals expressed in S. 898—the legislation developed by this Committee in the First Session of the 97th Congress.

THE 1982 CONSENT DECREE

Description of the decree

For reasons I will discuss in a moment, the 1982 Consent Decree is a modification of the 1956 Decree. Under the terms of the modified decree, AT&T would divest the local operations of 22 Bell Operating Companies (BOCs)—the facilities by which customers complete local calls and gain access to long distance and international networks. Such facilities represent approximately two-thirds of the Bell System's total plant, or over $80 billion in assets. The resulting Local Exchange Companies (LECs) are required to provide equal access to their local services to all interexchange carriers and information service providers under terms which are virtually identical to those contained in S. 898.

All Bell System interstate long distance facilities and a portion of the intrastate long distance facilities now owned by the BOCs, will remain with AT&T. Ownership of customer premises equipment also will be retained by AT&T, along with the Western Electric manufacturing subsidiary and Bell Laboratories.

Of the Bell System's approximately one million employees, about half will work for the new LECs upon divestiture while the other half will work for AT&T and the units affiliated with it.

According to the modified decree, the divestiture will take place within 18 months. A plan for reorganizing the Bell System to accommodate this divestiture must be filed with the Department of Justice within six months of the effective date of the modified decree.

Modified decree filing procedures

Removing the restrictions of the 1956 Decree is the cornerstone of the agreement with the Department of Justice to divest local exchange properties and operations. Therefore, the 1956 Decree was modified to reflect the new agreement and the 1974 suit was dismissed.

At the same time that the Department of Justice and AT&T filed a Stipulation for Voluntary Dismissal in the D.C. Court suit, we asked Judge Biunno in New Jersey to transfer the 1949 suit to the D.C. District Court so all proceedings pursuant to the 1956 Decree would be under its jurisdiction. Our purpose was to consolidate all consent decree matters in one convenient court here in Washington.

We have from the very start anticipated hearings permitting public comment and judicial review of the Decree. Under Judge Greene's order of January 21, these hearings will be held expeditiously. We want to get on with the business of restructuring the Bell System. We have a mammoth job to do to implement the decree. One million Bell System employees, three million shareholders, our bondholders, and millions of customers anxiously await resolution of this matter.

Effect of removing the 1956 decree

Lifting the 1956 Consent Decree—the cornerstone of our agreement to divest local exchange operations—removes restrictions imposed by that Decree on AT&T. This action along with preserving Bell Laboratories and Western Electric as integral parts of AT&T—technologically integrated with the Bell System part of the nationwide network—promises to be a key element in maintaining America's world leadership in the Information Age and in the technology on which that leadership is based.

Reasons for negotiating a decree

Over the last several years there has been a continued blurring of the distinctions between communications and data processing technologies. The nationwide public switched network is in fact the world's largest special purpose computer with that special purpose being communications.

Clear signals have been emerging from the deliberations of Congress, actions of the FCC, and actions of the courts that the public interest is best served by a competitive marketplace—a marketplace in which technology and entrepreneurial ingenuity can be exercised to their fullest to bring products and services of the Information Age to all Americans with regulation limited to basic telecommunications service.

The modified decree preserves the free flow of technology from Bell Laboratories. It enables us to provide to the public Information Age products and services far sooner than if we had elected to seek resolution of the interminable uncertainty surrounding the future role of the Bell System in other forums. The modified decree should simplify the deliberations of the Congress as it seeks to update the outdated Communications Act of 1934. The issue of Bell System size and structure is no longer a stumbling block.

IMPACT OF THE MODIFIED DECREE ON GOALS OF S. 898

1. Goal—High-quality service at reasonable rates

At the outset let me state unequivocably, the upward pressure on telephone rates we all are hearing so much about is a result of today's competitive environment and inflation, not the modified consent decree. The Bell System has a long, successful history of holding down the cost of services to the nation's telecommunications users. In a 1927 speech to the NARUC, then President of AT&T, Walter Gifford, spoke about the Bell System's obligation "to furnish the best possible telephone service at the lowest cost consistent with financial safety". The foremost principle underlying the Communications Act is that basic telecommunications services should be available to all people of the United States at reasonable rates. Upward pressure on rates is a result of today's competitive environment and inflation, not the modified consist decree.

Over the last decade, records of many hearings relating to the growth of competition in the telecommunications industry have pointed to one inevitable outcome—rates for services will be driven toward costs. The firm which is forced to price to cover costs not associated with products it is selling will soon find itself unable to compete. The firm which prices below costs will not remain in business long.

In his appearance before the Subcommittee on Communications of the Committee on Commerce, Science, and Transportation, on March 21, 1977 my predecessor as Chairman, John D. deButts pointed out this economic reality—"'Competition'—even contrived competition—forces prices inexorably toward costs."

In November 1979, NTIA under the direction of Henry Geller addressed the movement of rates to costs in a competitive environment with particular emphasis on the need to reevaluate the cost allocations referred to within the industry as "separations and settlements". In its "Primer," NTIA stated:

"As competition has been introduced into the provision of interexchange services, there is increasing pressure to reevaluate these allocations. This is so because it will be necessary to price traditional long distance service more closely to the cost of providing that service in order to compete with other carriers offering alternative services."

Rates also will reflect the more rapid capital recovery necessary as competing firms employ technology seeking to use the latest advances to meet user expectations.

Also contributing to the upward pressure on rates were the cost allocations from intrastate to interstate which had been used as a means of subsidizing local service rates. Over the years regulators assigned an increasing proportion of local exchange plant to the interstate jurisdiction.

The new decree contemplates that tariffs will be filed which could be the means of support for the local exchange companies. The FCC currently has an access charge plan under review which is consistent with the decree requirements and would provide such support for local exchange rates.

The Bell System has a long standing commitment to service which we must continue to honor to be successful in today's competitive environment. The companies which will be divested must be strong if they are to meet this commitment in the future.

Accordingly, the decree requires AT&T to assure that upon divestiture the LECs have sufficient personnel, facilities and rights to technical information to permit them to perform their functions. For a five-year transition period, AT&T, Western Electric and Bell Laboratories will provide on a priority basis the manufacturing, research and development services needed by the LECs to implement the Decree.

With established customer acceptance, an excellent management team, a strong balance sheet, strong revenue streams—measured local service and access charges—full freedom to apply technology, and the continued oversight of state regulatory bodies, the commitment to the best possible service at the lowest possible cost should continue undiminished in these new companies.

2. Goal—Promote competition by lowering entry barriers

The establishment of LEC s eliminates any incentive or potential to use local exchange facilities as a bottleneck. The incentive of Bell's divested LECs will be to connect any and all users to local exchange facilities thereby enhancing the local access revenue stream. The local access charge revenue stream will be important to the financial viability of the LECs.

Recent FCC decisions which have been designed to reduce barriers to entry into the telecommunications industry are not affected by the modified decree. The recent decision to permit resale and sharing of Bell System private line, MTS and WATS services allows entrepreneurs entry into the business with a minimum capital investment. Similarly, the recent order requiring AT&T to unbundle its private line rates allows any potential customer or competitor to choose those pieces of private line rate offerings they wish and resell them as part of their own service package in competition with AT&T.

3. Goal—Prohibit cross-subsidy

Under the terms of the modified decree the intercity enterprise has no corporate affiliation with the supplier of local exchange services. Thus, this potential for anticompetitive cross-subsidy is eliminated. The extensive competition and ease of entry in long distance business removes any problem of cross-subsidy there.

Under the terms of the modified decree the LECs are not permitted to have a manufacturing affiliate. Thus, the LECs will have no alternative but to purchase the best products for the least costs uninhibited by any manufacturing affiliation.

With the potential for anticompetitive cross-subsidy and bottlenecks eliminated by the terms of the modified decree, AT&T should not be inhibited in ways any different from other organizations in the telecommunications and information related businesses.

4. Goal—Recognize needs in area of national security, defense, and emergency preparedness

The modified decree preserves the unified management of the nationwide public long distance network and, by mandating a central point of coordination in the LECs takes explicit account of national security and emergency preparedness requirements as charged by the Communications Act of 1934. As details of the divestiture are developed in greater detail, these national concerns will continue to be addressed. We, of course, will cooperate fully with the Department of Defense and all other agencies of the Federal Government which have responsibilities in these areas.

5. Goal—Retain viability of U.S. competitiveness abroad

Lifting the constraints of the 1956 decree has the benefit of enhancing the competitive viability of the remaining high technology AT&T enterprise in competing in overseas markets. AT&T will be able to contribute to America's leadership in overseas Information Age markets, creating jobs for American workers and contributing to a favorable balance of trade.

6. Goal—Deregulation as competition develops

The modified decree is a positive influence in a marketplace for long distance services in which competition is already flourishing.

Between 1977 and 1981 cities served by OCCs grew 15-fold—18 to 196.

Nearly 90 percent of those living in the urbanized SMSAs—the prime market—now have access to competitive alternatives.

In 85 areas customers have a choice of AT&T and three other carriers.

In 126 areas customers have a choice of AT&T and two other carriers.

Growth rates of these competitors of 40 percent per year are common.

177 Reseller Applications are before FCC.

By 1986, AT&T's share of the deployed domestic satellite capacity will be only 15 percent.

The modified decree is a positive contributor toward the growth of competition. It cannot address the goal of deregulation. Congress may wish to do so in light of flourishing competition.

The modified decree is, I believe, in the public interest. It goes a long way to resolving many of the most fundamental issues facing the Bell System today. Most importantly, it meets the goals of S. 898 as passed by the Senate.

The Chairman. Next, we'll take Sherman Unger, the General Counsel for the Department of Commerce, and Bernie Wunder, Assistant Secretary for Communications.

Mr. Wunder, I understand you're going to be presenting your statement; is that correct?

STATEMENTS OF HON. BERNARD J. WUNDER, JR., ASSISTANT SECRETARY FOR COMMUNICATIONS AND INFORMATION; DEPARTMENT OF COMMERCE; AND SHERMAN UNGER, GENERAL COUNSEL

Mr. Wunder. Yes, Mr. Chairman.

The Chairman. Go right ahead.

Mr. Wunder. Mr. Chairman, I think to make this more productive, I would ask that my statement be placed in the record. I have made a few notes concerning the issues that have come up this morning and I would like to deal with those orally.

The Chairman. Your entire statement will be in the record.

Mr. Wunder. The problems that have been talked about this morning and which S. 898 and its House counterpart sought to address, other than the question of A.T. & T.'s structure, are problems that have developed as a result of effort to forge a more competitive telecommunications industry.

In my view, these problem areas not adversely impacted by the proposed settlement nor are they favorably impacted by it. The settlement dealt with single issue of A.T. & T. structure. The settlement enhances the prospect for a more competitive telecommunications environment by dealing with the question of A.T. & T.'s structure from the equipment standpoint. It eliminates the captive market for Western Electric products and resolves the question of equal access to the local exchange facilities of the Bell operating companies.

With respect to the specific issue of local rates, I would agree with what Mr. Brown said. Local rates are going up, and have gone up. This is a result of the competitive environment which is driving the rates for local service toward cost. That was the policy issue that S. 898 tried to deal with: on the one hand, there is the desire to keep the access charges low for the long-distance competitors; and on the other hand, there is the desire to maintain the subsidy at high enough levels to keep local rates low. The question is how to balance those two interests.

I think another reason local rates have gone up, again as a result of competition, is actions such as accelerated depreciation, in order to modernize plant, and to replace equipment more quickly.

Clearly, there are preexisting regulatory mechanisms that are not affected by this settlement that can address the question of local rates. The State commissions have the authority to deal with the question of exchange access for intrastate long-distance calling. The mechanism is there to deal with the question of local rates through that access charge. With respect to interstate calls, the FCC has the authority. The FCC has been looking at this matter for some time.

With regard to the question that Mr. Brown raised: Should access charges became too high—either those set by the States or those set by the FCC—will that drive persons and users off the network? This issue also existed before. It was raised in the hearings on S. 898, and it was suggested that there are mechanisms to deal with those who go off network. The spectrum fee is clearly one mechanism. Another is an access charge mechanism for those who go off network.

In terms of the DOD concerns, those were preexisting and are a result of the competitive environment. There simply were more carriers to deal with than previously. Also before competition, A.T. & T. would do a considerable amount in terms of hardening sites, for example, which it would include in the rate base which no longer became viable as a result of competition.

In a positive sense, from the DOD standpoint, the proposed settlement keeps Bell Labs and Western Electric together. They are not divested into many small parts that could diminish their efficiency.

Another point that I would make is that Bell Labs and Western Electric are still available to the operating companies. They simply will deal with them on a different basis. No longer will the research be funded by the license contract, but clearly the abilities of Bell Labs will be available to the Bell operating companies on a contractual basis.

I think the only thing mentioned in my testimony that I haven't covered so far is that, the issue regulatory forbearance and of deregulation will become more important as a result of the settlement. With that, Mr. Chairman, I'll be glad to respond to any questions that you and the other Senators may have.

The CHAIRMAN. Let me ask you this. We presently subsidize local rates with long-distance charges. Is there anything in the consent decree that changes the present method and procedure of determining the subsidy?

Mr. WUNDER. I can see nothing in the settlement that does that, Senator Packwood. As I see the situation developing, the tariffed exchange access charge will be based upon the same formulas and the same cost division that exists this time. It will do much the same thing as your bill did.

The CHAIRMAN. Our bill makes it statutory, whereas today we are resting on the continuing policy of the Federal Communications Commission which could change.

Mr. WUNDER. That's exactly right.

The CHAIRMAN. I have no other questions. Senator Schmitt?

Senator SCHMITT. Bernie, do you see the decree meaning that operating companies cannot sell terminal equipment?

Mr. WUNDER. Yes, sir.

Senator SCHMITT. Does this seem a little bit incongruous to you, to have an "operating company" that can't sell internal equipment, or telephones specifically?

Mr. WUNDER. That was the same approach that was taken by S. 898, that the Bell operating companies themselves could not sell terminal equipment. I think that——

Senator SCHMITT. I think we'd better stop right there because S. 898 did not envision the divestiture of the operating companies, and that situation is a little bit different.

Mr. WUNDER. You are right in that sense. But in terms of the Bell operating companies and their inability to sell terminal equipment, we have a situation similar to what S. 898 sought to address namely, if the operating companies continue to offer terminal equipment, they would have an advantage over all other competitors. So, I see the situation as essentially the same, and not unlike the situation with electric companies where one company provides the service, and another the equipment.

Senator SCHMITT. So, the situation we have if this consent decree became the law of the land is that a person served by an independent will be able to buy his or her telephone from the phone company, but a person served by Bell operating company will not be able to do that.

Mr. WUNDER. That's correct.

Senator SCHMITT. Will the Bell operating companies under the decree be able to install inside wiring?

Mr. WUNDER. That is a question, as to where exactly that line is drawn——

Senator SCHMITT. Pardon the pun.

Mr. WUNDER. Pardon the pun, right. The question is whether inside wiring would be CPE because it's located on the customer's premises, or whether it would be part of the local network. In my judgment, inside wiring is probably CPE. That being the case, the Bell operating companies probably would not——

Senator SCHMITT. CPE being customer premises equipment?

Mr. WUNDER. Because that wire is located on the customer premises it seems to follow that it would be CPE, but that's an interpretation. It is not totally clear from the terms of the decree.

Senator SCHMITT. So, if we're going to proceed with legislative action with or without the consent decree we ought to make sure that's clear.

Mr. WUNDER. I would think that's right.

Senator SCHMITT. Bernie, do you have any further comments on the question that I raised earlier, and others have raised, about State commissions and the political environment in which they will operate; and if that's altered in any way by the consent decree?

Mr. WUNDER. I wouldn't think it would be altered in any way. I understand the logic of your comments. I don't see that that is radically changed from the existing situation.

One of the reasons that questions of exchange access and questions of surcharges and the like were essentially pre-empted from State control in the legislation was because of the regulatory environment in the States. I don't see that as being radically altered by the consent decree.

Senator SCHMITT. Do you agree with the policy that is explicit in the consent decree and also in S. 898 that extends Federal jurisdiction to intraexchange service within the individual States?

Mr. WUNDER. Yes, sir, I do. The technology that exists now simply doesn't respect geographic lines. The use of satellites and microwaves, and the ability to switch a call from St. Louis to another part of the State of Missouri by routing it through Chicago simply no longer respects those territorial boundaries.

Senator SCHMITT. Do you see the consent decree in any way changing the need for a uniform system of accounts?

Mr. WUNDER. No, sir, I don't. I think you're still going to need a uniform system of accounts to deal with the remaining questions of A.T. & T.

Senator SCHMITT. Were you surprised that the FCC was not consulted on the design of a consent decree?

Mr. WUNDER. Not really. We in the executive branch look at the settlement of the case as an issue clearly within Justice's jurisdiction. Although we in Commerce were involved with the legislation, the settlement of the case and the decree was peculiarly within Justice's purview.

Senator SCHMITT. I like your use of the word, "peculiarly."

Thank you, Mr. CHAIRMAN.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Thank you, Mr. CHAIRMAN. Let me inquire, did the Commerce Department play an active part in the negotiations that were going on here to settle this matter?

Mr. WUNDER. No, sir.

Senator RIEGLE. Were you asked to make any input along the way?

Mr. WUNDER. No, sir.

Senator RIEGLE. So, you're getting in after-the-fact; is that right?

Mr. WUNDER. We're not "in."

Senator RIEGLE. Why are you here? You're saying that you don't consider yourself in. You're just commenting on what you see to be the effect here.

Mr. WUNDER. Yes, sir.

Senator RIEGLE. And, you had no active part other than that in this decision or what will come out of it here?

Let me ask you this: Have you tried to assess the question that we were raising earlier about what some see as the risk that local phone rates might go up as much as 100 or 200 percent over the next, say, 1, 2, or 3 years?

Mr. WUNDER. Senator Riegle, local phone rates might go up that much, but they could go up in any event. If they go up in any significant way, that assumes the absence of any action taken by either State or Federal regulators. Local phone rates could only go up that much in the absence of any action. I don't see that happening.

Senator RIEGLE. What do you see happening in that area?

Mr. **Wunder**. As the FCC has looked at the question of access charges, I see the States looking at the question of access charges, for instance, of State long-distance charges—absent any legislation that would make it a long-distance intrastate subject to FCC jurisdiction.

Senator **Riegle**. So, what do you foresee in the way of rate increases if this goes forward?

Mr. **Wunder**. That is problematic. The loss of Yellow Pages revenue and the removal of terminal equipment from the rate base are issues that can be dealt with by the regulatory bodies. For instance, the FCC was considering the transfer of terminal equipment out of the operating companies to the subsidiary to another part of A.T. & T., while treating the equipment for ratemaking purposes as if it were still owned by the operating companies.

Senator **Riegle**. Have you done any estimates as to what the impact would likely be, on the average, to local phone rates depending upon the answers to these various questions of the kinds you were just citing?

Mr. **Wunder**. No, sir.

Senator **Riegle**. I think you should do so and I would like to urge you to do so. It would be useful for us to have your assessment as to what the potential impact might be on local rates depending on how these other questions are sorted out. Because, if you foresaw the prospect of a major increase in local rates within a short period of time, within the next year or two or three, I think it would be important for us to know that and I think there is some obligation to make a careful estimate in this case and I would like to ask that you do so, if the chairman would agree with that.

The **Chairman**. I would agree. I think, Bernie, you can accommodate that; couldn't you?

Mr. **Wunder**. Yes, sir. We do have people looking at that right now, but we have not completed the study.

The **Chairman**. Good.

Senator **Riegle**. Thank you.

The **Chairman**. Senator Danforth?

Senator **Danforth**. It is my understanding that this is—this proposed decree is not a work product of the Commerce Department. If you were grading the proposed decree between "A-plus" and "F," how would you grade it?

Senator **Schmitt**. "C-minus" is not an acceptable answer.

Mr. **Wunder**. "B-plus."

Senator **Danforth**. How about you, Mr. Unger?

Mr. **Unger**. "B."

Senator **Danforth**. I'd like to ask each of you in turn why you wouldn't give it an "A-plus." What major faults would you find in it?

Mr. **Wunder**. One that Senator Schmitt has raised is the question of whether inside wiring is CPE or local exchange. There may be some regulatory jurisdiction problems as well, whether, for instance, the Bell operating companies are what is known as section 2(b)(2) carriers under the decree. But I don't think that those are insurmountable problems.

The **Chairman**. The regulation of section 2(b)(2) companies is solely entrusted to States; is that right?

Mr. WUNDER. That's right, and that's what the divested local exchange companies would seem to be.

Senator DANFORTH. Anything else?

Mr. WUNDER. That's all I can think of off the top of my head.

Senator DANFORTH. How about you, Mr. Unger?

Mr. UNGER. I need to hear the terms spelled out in a little more detail. I think the agreement to amend in principle is sound, but there are a lot of parts of it that really aren't spelled out yet. We need to know, for example, how the divestiture will be executed, and there are a number of other questions yet to be dealt with.

Senator DANFORTH. A number of concerns have been expressed. I suppose the principal one is the possible effect on what the consumer is paying for local telephone service. It's my understanding that it's your judgment that the proposed decree would not have an effect on that.

Mr. WUNDER. Yes, sir.

Senator DANFORTH. Another concern is that this frees this enormous company to enter into markets that it cannot now enter, and when that happens it has a negative effect. Perhaps maybe it's a positive effect on what is now going on in those markets. Do you have any concerns in that section, or is that not your field?

Mr. WUNDER. The concern previously was the fact that A.T. & T. owned and operated a natural monopoly, namely the system for the local distribution of telephone calls. That concern no longer exists. It seems to me that the justification for keeping A.T. & T. out of businesses such as data processing and information services no longer exists as well. That problem has been solved as a result of this proposed settlement, assuming that it goes through.

Senator DANFORTH. You think it's been solved?

Mr. WUNDER. Yes, sir. That issue has been solved.

Senator DANFORTH. The issue of A.T. & T. getting into data processing and various communications fields that it's not in now, that's been solved?

Mr. WUNDER. I think once A.T. & T.'s ownership of the natural monopoly is terminated, A.T. & T. will be in a position similar to other large companies which do not own natural monopolies.

Mr. UNGER. Let me add that I don't see a sophisticated sales force in A.T. & T., where their competitors seem to have one. They are not starting at an equal advantage.

Senator DANFORTH. So if you were IBM, you wouldn't be particularly concerned about this?

Mr. UNGER. I wouldn't go that far, but I would think I had a great lead on it because I had a sophisticated force in place, in being, and trained to sell.

Senator DANFORTH. Supposing you were a newspaper. Is there a concern to be felt by the local news industry that here you have a possible sudden rush of attention and resources into getting information, news-type information into a home? Granted, there is a severance of the relationship between the local phone company and A.T. & T. Still you have a freeing of this giant to address its attention to communicating news and information in a different way into the home. Should a newspaper be concerned about this?

Mr. WUNDER. Senator Danforth, over the last 2 years I have spoken with numerous representatives of newspapers. What was uniformly cited to me as the problem with A.T. & T. and A.T. & T.'s entry into information services, was the ownership of the local loop. That no longer exists. When I delved into their concerns as to why the separate subsidiary structure would not take care of the problem, they cited the ownership of the local loop. That, in their mind, was the nub of the problem.

Quite frankly, I didn't see it as a problem even when A.T. & T. owned the natural monopoly. I think the question was the equality of access to the natural monopoly. The incentives to give preferential treatment to one person over another have been ameliorated by this consent decree and that seems to me to address the problems cited by the newspaper publishers in their testimony before this committee and in my private conversations with them.

The Chairman. Jack, I think if my memory serves me right, when the newspaper publishers testified about competition with Bell, I raised the issue about the Los Angeles area because that's G.T. & E.'s area. The publishers said they didn't mind Bell competing there because they didn't own the loop. Today, as I look at the asset structure, Exxon will now be a bigger company than A.T. & T., will it not, in terms of its assets?

Mr. WUNDER. Yes, sir.

The CHAIRMAN. So you face the question, if you're going to bar the divested A.T. & T. from competing in classified information, do you bar Exxon which is bigger, or Mobil which is slightly smaller, or any number of companies which I presume are significantly more liquid than A.T. & T. might be in terms of getting into this business?

Last week I spoke in Eugene, Oreg., at the university's journalism school. A young fellow came up—couldn't have been more than 25 or 30, and he's starting to do what I envisioned would happen. He's getting into the classified advertising business, not bothering to worry about the overhead of the newspaper. He's going to sell classified advertising on cable. I bet when all is said and done, that kind of competition will be a greater problem to the local newspapers than major corporations centered in New York, where you have a small business with no more than a half a dozen people who will not value their time, who will work 12, 14 hours a day, 7 days a week, and will be successful at what they're doing.

Mr. WUNDER. I quite agree with that, Senator.

The CHAIRMAN. I think that's one of the reasons why you see newspapers buying cable systems. I won't mention which paper it was, but I was at a meeting with eight or nine of the newspaper publishers in Oregon one night and they were having a heated debate about cable. One of the publishers said, "I'm not worried about that," and the other said, "What are you going to do when the line goes into every home and competes with you?" He said, "I'll buy the line."

I have no other questions. Senator Schmitt?

Senator SCHMITT. Yes. I'm a little bit curious in your rating that it's as high as it is, because we really gave short shrift to the idea of divesting operating companies during the legislative consideration of S. 898 and its precursors. Nevertheless, we get from you a fairly high grade for the consent decree, which takes almost an opposite tack to where the administration, absent the Justice Department and the Congress, were headed. Would you care to explain why you suddenly think this is such a great idea when it was not really thought of as a great idea just a few weeks ago?

Mr. **Wunder**. We were primarily interested, Senator Schmitt, in moving ahead and achieving certainty in the telecommunications industry. It appeared to us last year that the judicial process was going to take an extremely long time. Some of our estimates that we gave were as long as 10 years before it got through all of the appeals. The settlement, it seems to us, does provide the certainty that we can go on from now.

Senator **Schmitt**. So it gets an automatic B, just because it's a settlement; not based on any inherent quality that it may have?

Mr. **Wunder**. I think it probably gets an automatic C for that purpose. I think the higher portion of the grade would come from the fact that it does deal with the questions of equipment procurement by the Bell operating companies which was one of the issues that was hotly debated in S. 898 and led to the procurement provisions. It also deals with the question of equal exchange access, which was another hotly debated item, which led to the so-called Baxter-2 amendment.

Senator **Schmitt**. Is it safe to say, Bernie, that you feel the pressure of competition, the pressure of public complaints about decrease in service, and just general political pressure, are significant if not sufficient to maintain local rates at a lower level than might otherwise be expected in a technical sense under this consent decree?

Mr. **Wunder**. I would think that would be right.

Senator **Schmitt**. Thank you, Mr. Chairman.

The **Chairman**. Senator Danforth?

Senator **Danforth**. Nothing.

The **Chairman**. I have no other questions. Gentlemen, thank you very much.

[The statement follows:]

Statement of Bernard J. Wunder, Jr., Assistant Secretary for Communications and Information, Department of Commerce

Thank you for this opportunity to discuss briefly some of the regulatory reform and related steps that are needed in light of the proposed settlement of the Justice Department's antitrust action against AT&T.

On Friday, January 8, 1982, AT&T and the Justice Department jointly announced that they had agreed to a Government-proposed consent decree settling the antitrust case Justice commenced in November 1974. Procedurally, the new, proposed consent decree would modify the 1956 *Western Electric* judgment that ended a previous antitrust suit filed against AT&T by the Government in 1949. The new decree was entered in the New Jersey U.S. District Court on January 14, 1982. It has been transferred to Chief U.S. District Court Judge Harold Greene's court in the District of Columbia for public comment and review.

Substantively, the proposed settlement potentially resolves perhaps the chief issue affecting the domestisc telecommunications industry, namely, the structure of AT&T. Under the terms of the new decree, AT&T would divest the local exchange telephone operations of its 22 wholly (or majority) owned Bell System operating companies. Six months after the effective date of the new consent decree, AT&T is to file a divestiture plan with the Justice Department. Assuming that the plan is acceptable, divestiture would be accomplished at the end of a further 12-month transition period.

The proposed divestiture would leave AT&T with three main components: (1) its Long Lines Department (plus the intercity communications facilities now owned by its operating companies); (2) the Western Electric Company—currently the Bell

System's manufacturing, marketing, and supply arm; and (3) Bell Labs, one of the premier basic and applied research and development institutions in the world. AT&T's Long Lines operations would continue to be subject to economic regulation, presumably by the Federal Communications Commission (FCC). The current restrictions on the scope of AT&T and Western Electric's commercial activities contained in the 1956 *Western Electric* decree would be eliminated. These firms would thus be permitted to offer new, non-communications, and non-regulated products and services to the public.

From the perspective of the Department of Commerce, freeing AT&T and Western Electric from the outmoded restrictions of the 1956 *Western Electric* consent decree is of fundamental importance. Once the divestiture plan is fully effected, Western Electric and Bell Labs will be able more efficiently to use their research and manufacturing talents in our competitive and expanding communications marketplace, both at home and abroad. As Secretary Baldrige testified before the committee last June, this country has the capability to rapidly expand its commercial and trade activities in the telecommunications field worldwide. We cannot accomplish this very important goal, however, if the leading firms in our dynamic telecommunications and information services industries are hobbled by obsolete constraints. By allowing Western Electric and AT&T to enter new markets, and to respond to competitive challenges at home, the proposed decree should strengthen their ability to compete more effectively abroad.

While the proceedings to review the proposed modification are underway in Chief Judge Greene's court, there will unquestionably be discussions regarding the continuing need for telecommunications legislation. In the balance of my statement here today, I will discuss some of the important public policy issues that the proposed settlement does not—and should not be expected to—resolve. Some of these issues may be resolvable through administrative action by the FCC. Others may require new legislation. All of these matters, of course, will be closely studied and reviewed by the administration, as the dust settles from the proposed *AT&T* consent decree.

Three important—and currently unresolved—public policy issues we will be studying are as follows:

Rate stability issues

Both the House and Senate telecommunications bills (H.R. 5158 and S. 898) contain so-called "safety net" provisions relevant to local rates. These provisions were designed to ameliorate the rate increases associated with the ongoing shift in the industry toward cost-based pricing. Their aim is to preserve the universal availability of basic telephone services at affordable rates, especially in rural areas.

The proposed settlement does not alter current "separations and settlements" arrangements, whereby a substantial part of the cost of providing basic local phone service is now borne by the industry's long-distance enterprises. The proposed settlement also envisions the establishment of an access charges system, along the lines of the system that the FCC has been considering for some time (CC Docket No. 80-286).

The principal focus of the proposed *AT&T* case settlement is fostering greater competition and economic efficiency in the intercity communications services business. It is not necessarily aimed at furthering the traditional social policy goal of maintaining basic, universally available phone service at affordable rates.

Local telephone rates have increased significantly in the past five years. This is chiefly the result of inflation. It is also because of the competition-driven trend toward straight cost-based pricing increasingly prevalent throughout the telephone industry.

We do not now know whether the proposed *AT&T* settlement will result in rate increases of the magnitude some experts have predicted. The FCC, as well as State regulatory commissions, can deal with this issue to some extent. It is also an area, however, where Congress might appropriately choose to act at some future date.

Regulatory forbearance and deregulation

Under the proposed settlement, major parts of AT&T and all of the divested local exchange operations would continue to be subject to pervasive economic regulation. The ability of the FCC to forbear from regulating even effectively competitive telecommunications services is not settled under existing law. It is also uncertain whether the FCC can choose to deregulate such services and, at the same time, preempt State regulation.

S. 898 commendably accords the FCC explicit authority to deregulate effectively competitive communications services, and resolves many troublesome issues of overlapping Federal and State regulatory jurisdictions. Additionally, the bill would essentially deregulate new, computer-data processing related services, and thus ensure that these promising new offerings are not distorted because of unnecessary economic regulation. S. 898 further seeks substantially to simplify traditional tariff and construction authorization procedures and requirements. I believe that the pace of deregulation can be legislatively accelerated as a result of settlement.

National Defense

S. 898 contains extensive provisions dealing with important national defense and security and emergency preparedness concerns. The proposed *AT&T* settlement does contain provisions aimed at ensuring that the telecommunications industry will be able to continue to meet the requirements of national defense and emergency preparedness. See, e.g., sections I(B), II(D)(2). Unlike S. 898, however, the proposed settlement does not obligate the FCC to consider national defense and security and emergency preparedness matters, and to accord them their appropriate weight. No antitrust decree can accomplish such goals. The courts have held, however, that national defense interests are of paramount importance. This may be an area where administrative and judicial actions eventually will resolve some of the problems. We believe, however, that this is a critical area where the most cost-effective and desirable approach is legislation along the lines of the network planning and management sections of S. 898.

CONCLUSION

In conclusion, the proposed AT&T settlement, when it is fully implemented, should have a positive and desirable effect on both domestic and international telecommunications markets. The settlement will have the effect of freeing the leading firms in the field—AT&T and Western Electric—from the obsolete restrictions of the 1956 *Western Electric* consent decree, a result that we strongly support.

The Department of Commerce as well as other cognizant executive branch agencies will be reviewing the proposed settlement, and its likely results, carefully in the weeks to come. We are not prepared at this time to state exactly what legislation may still be in order with respect to the rate stability and forbearance issues. We do, as I indicated, strongly support legislation on the critical national matters. Following the completion of our study and review and appropriate review within the executive branch, our recommendations, on these two other points will be made to the Committee.

The CHAIRMAN. Next let's take Gen. William Hilsman, the Director of the Defense Communication Agency and the Director of the National Communications System.

STATEMENT OF GEN. WILLIAM J. HILSMAN, DIRECTOR, DEFENSE COMMUNICATIONS AGENCY AND MANAGER, NATIONAL COMMUNICATIONS SYSTEM, WASHINGTON, D.C.; ACCOMPANIED BY J. RANDOLPH McPHERSON, REGULATORY COUNSEL

General HILSMAN. Mr. Chairman, gentlemen, thank you very much for letting me return to give you the Defense views on the current proposed settlement. I also have a statement that I would like to submit for the record. What I would like to do now is just summarize it for you and leave a maximum amount of time for questions.

The CHAIRMAN. Your statement will be in the record.

General HILSMAN. As you may recall, our previous testimony stressed our reliance here in the Continental United States on the commercial common carrier system for our critical national defense and emergency preparedness requirements. I described to you a NATO environ where over 50 percent of our communications in the central region in NATO are provided, owned, operated and maintained by soldiers, sailors, airmen and marines. And I mentioned to you, Senator, that region is as big as the State of Oregon.

When we come back to the United States, that's not so. All of our critical circuitry, SAC circuitry, Presidential support circuitry, warning circuitry, NORAD circuitry is provided by the common carrier system. When something goes wrong in this Nation today, in any kind of an emergency, the Federal Government really doesn't have the capability to respond. I get the call, I call A.T. & T., and they take charge. They work with the independents, they work with their own operating companies, and that's how we get things done in the Nation today to fix any kind of a problem we have and to handle any kind of an emergency.

We supported legislation when we were here before in three broad areas. First, the recognition of national security and emergency preparedness in the law. Second, the requirement that the necessary joint Government-industry preplanning be accomplished to be sure that we can respond. If we're going to have some kind of an emergency that comes upon us that's really large, if we haven't thought about it in advance, if we haven't done something to work toward it in advance, when we have to respond to it we're not going to be able to do it very well.

A good example, by the way, in another nation is what happened in Italy over a year ago on the earthquake there. If you look at that earthquake outside of Naples and you recognize, had they been able to think through their communications requirements, be ready for them when they occurred, they could have done an awful lot better. We're doing some lessons learned on that. That's very obvious at the moment.

The third area that we supported legislation in was the provisions that will allow either A.T. & T. or any operating company to provide end-to-end telecommunications service for national security and emergency preparedness requirements. We didn't believe we could be in a position to ask the SAC commander to deal with an A.T. & T. for the long lines, then go to a separate operating company to deal with the phones in the Minuteman sites, for example. We wanted one person he could call to deal with that entire network.

The CHAIRMAN. Let me ask you very quickly, your fundamental disagreement with the consent decree's divestiture, then, is that you're going to have separate companies at the end?

General HILSMAN. Let me say, sir, that your bill, S. 898, addressed all of these issues and addressed them completely to our satisfaction. So there is a way to do it.

The CHAIRMAN. But is there any way to do it based upon that last point that you made? If you have divestiture, how are you going to have point-to-point communication guaranteed if you have divested local companies?

General HILSMAN. We do it today outside the Bell area. Some of those SAC circuits are provided by G.T. & E. We still call A.T. & T. The Justice Department and A.T. & T. are aware of these needs. I don't think they have any problem with them. We have to get them into a law or into something to allow us to do it. In the national security emergency preparedness areas I don't think we have any objections from anybody to what I've just said. We just have to be sure that we get them into something to allow us to do it for those kinds of issues.

The CHAIRMAN. If you're satisfied with that, I think what you're saying then, if we pass the provisions that are in S. 898, that will still take care of your problem even with the consent decree.

General HILSMAN. Generally speaking, yes, but I'd like to propose to you a couple of questions we have with the consent decree. You are exactly right, we are continuing to support the legislation that we had before you in S. 898 and that you handled so well for us, not only for the three reasons that I talked about, but we've got an issue sort of in the industry today with what I describe as three basketball games going on in the same court at the same time with all the players wearing the same uniforms, three basketballs flying around, and you're trying to watch with some pillars in front of you. Because you've got the FCC that's come up with some ways of restructuring the industry. Now we've got the Justice-A.T. & T. proposed settlement that really doesn't quite throw the other one out, and then we have S. 898, and we have something going on in the House. We really need to settle this industry down for the next 5 to 10 years so we can get on with it, and I think that's what your legislation can do.

Let me talk about the proposed settlement. We still have lots of unanswered questions—and by the way, I will say for the record that I appreciate and we appreciate both A.T. & T.'s efforts and Justice's efforts to take care of our needs. I met with the Justice people on two occasions, I met with Mr. Baxter on two occasions, to make sure they understood our needs. We've done the same thing with A.T. & T. I believe they recognize those needs and try to take care of those, at least in a general sense, in what they said.

When we got the word on the proposed settlement, I formed two teams. I formed a DOD team to look at what that meant in terms of defense. I formed a National Communications System team—that's the other hat I wear—where I bring together State, CIA, Commerce, and everybody else to look at the Nation's needs. Those teams are meeting today. I'm also meeting with the independents, people from the other parts of this industry to get their input as to whether we have any problems in national security and emergency preparedness.

Here are the kinds of questions we're addressing. Standards, this network runs because we set standards and everything will play together. The way that's done today is the Bell Laboratories do it, the Bell Telephone Laboratories do it, kick them up to A.T. & T. corporate. A.T. & T. puts them down on their 22 operating companies. They coordinate those standards with the independents, but in fact, when those standards come down to those 22 operating companies, since that's 80 percent of the business, it happens. We have a standard system and the network will play.

We need to understand as we go forward, now, how standards are going to be done. I think it will work out because the network needs standards, all of the independents need standards. But we have to be sure we've settled that out. A.T. & T. recognizes that. I talked to them about it, and the independents recognize that. We've got to come up with a structure by which we can continue to set those standards.

Let me give you a second issue. In March 1975 in New York City, one of the biggest buildings up there that contains telephone equipment burned down. It had a class 5 exchange. That's the exchange that's a local one to you. It had five class 4 exchanges. A.T. & T. commandeered equipment and people from six of their telephone companies, from the Bell Labs and Western, and brought everybody together to New York Bell to solve that problem.

How will we do that under this kind of a proposal?

Well, as I've been talking to the independents, as I've been talking to A.T. & T., they kind of said, "Hey, well, we've done that in the independent area as well. We'll solve that problem as well, because this group of people are the kinds of people that do this kind of thing and they'll come together." And I believe they will.

Let me take this scenario up for you a little bit to another one we've been asked to address, because we look at all kinds of possible emergencies. What would happen if we had a major earthquake in California? When we look at that kind of a scenario, we see a lot more than four or five exchanges going. We say how would we respond to that?

The independents tell me, "We will all pull together." A.T. & T. says, "We'll all pull together." And I believe we will. But I surely know we'd have to have some kind of leadership in that kind of an emergency to pull it all together.

Today we would go to A.T. & T. I suspect tomorrow we would go A.T. & T., and they would, in fact, be able to best manage the restoration of that kind of a problem.

Let me take you to a different kind of a scenario though and another one that we had to deal with, the Cuban refugee problem, where we brought in, all of a sudden, into three different locations in the United States, a need to put communications into posts, camps, and stations when it wasn't there before. We went to Camp McCoy, Wis. We needed additional cable to do that. Wisconsin Bell didn't have that cable. A.T. & T. commandeered it from Illinois Bell, took it overnight, put it in, and the cable was there.

Same thing into Arkansas. They needed a microwave system that the Arkansas Bell folks did not have. A.T. & T. took it from another company, took it offline, in fact—it was revenue-producing—took it away from them, and put it in to solve that problem.

Well, that's one that's not quite a national emergency. In fact, those two States would probably just as soon not have even seen it at all. How are we going to be able to handle that kind of a problem, where the Nation needs something like that and it really isn't thought of as a national emergency? Who pays the bill?

In fact, who even has the records to know which other company has the cable, which other company has the assets? These are the kinds of issues we have to sort out.

One last kind of an issue is, when we took something from one operating company and put it in another, can we be in a position where we ask some of the operating companies or an umbrella over the operating companies to keep some assets for national security?

We have suggested, in the proposed consent decree, that there will be a point of contact. Who's going to pay for that? Who's going to pay for that group? Is that going to be in the rate structure somewhere?

And is a State—the questions that came up before, is a State regulatory agency, when they're looking at those bills and one of the telephone companies comes in and says "Here's what makes up our rate base, and here's this thing for national security," are they going to OK that thing being in there?

I think they will if, in fact, we get these provisions that we have asked for before in S. 898 into the law and we therefore have the law behind us.

So, let me summarize with the bottom line, because I know it's a question you'll ask me: Does Defense like the settlement?

Well, frankly, we like today's structure better. I agree with what Mr. Brown said, this is second best. However, we also recognize there are different forces in this Nation, all of which need to be recognized. With all of these forces and all of the different scenarios that we've worked, this is probably the best compromise that I can see. But I don't think any of us should make any mistake about it, because you all have somewhat the same responsibilities that I do, we are, today, moving from a system where, for national defense and emergency preparedness, we have an entity with economic and structural clout to do something right now. We are moving to a system where we will rely just a little bit more on good faith to kind of get these things done. And we believe that legislation can put the law behind much of this good faith.

Thank you, sir, for listening.

I'm prepared to answer any of your questions.

The CHAIRMAN. Senator Schmitt.

Senator SCHMITT. Thank you, Mr. Chairman.

Impressive testimony. Let me just clarify one point. When you talk about certain assets that might not exist in this new environment, I presume a good example would be redundancy, where when you look at the bounded problem of a local operating company in making a fair return on investment, that there would be certain redundant wiring, certain redundant capacity that you would eliminate over a period of time that in a national defense—national emergency context, would be very important to have. Is that an example?

General HILSMAN. I guess I don't see that problem very much, Senator, because, remember, A.T. & T. will still control the network down to the class 5. And all that redundancy that's in the network, the network, per se, will still exist. It's from the class 5 into—like a Camp McCoy where the issue comes up.

Senator SCHMITT. That's what I'm talking about, redundant local capacity.

General HILSMAN. We pay today for whatever we put in there, and I'm sure that those operating companies will put in anything we ask for as long as we pay for it. Where we will hurt is if they don't have that thing available right now and we have to get it from somebody else. They have to get it from somebody else.

In a competitive environ, 3, 4, 5 years from now, when Wisconsin Bell might ask Illinois Bell, Illinois Bell might say, "Well, why don't you ask Missouri Bell," that kind of a thing, because, you know, it can effect their bottom line. That's the kind of a thing I think we're concerned about.

I'm not sure I've answered your question, but I don't think it's specifically a reduncancy issue. I think it's more of an economic kind of an issue, what you will have available right now to do your own job. And then if you need something else in an emergency, you have to go get it from somebody else.

Senator SCHMITT. But don't you think that the total capacity of a local operating company system, assuming the spinoff is to 22 or some significant number of operating companies, local capacity will tend to become less under this agreement——

General HILSMAN. Yes.

Senator SCHMITT [continuing]. Because of the pressures on a rate structure that we talked about?

General HILSMAN. Sure. Yes. Like I said, this is not our proposed solution either.

Senator SCHMITT. I understand. All I'm trying to get is what your judgment is.

General HILSMAN. Yes, it will be less.

I think—as I said, I think we can get through it if we do the preplanning ahead of time that we talked about that we had in S. 898 before, but it's not as good as it is today.

Senator SCHMITT. The fewer operating companies that actually come into existence under this decree, the better for the Department of Defense——

General HILSMAN. Absolutely.

Senator SCHMITT [continuing]. If we ended up with large regional companies rather than 22 local companies?.

General HILSMAN. Absolutely.

Senator SCHMITT. Generally, your concern is coordination—how do you make things happen in a hurry when you need to have them happen?

General HILSMAN. Right, immediate response for an emergency.

Senator SCHMITT. The General Counsel for DOD, Mr. Taft, testified before the Senate Judiciary Committee in August. DOD had undertaken analysis of the effect of divesting local operating companies from Western Electric, Bell Labs, along lines of national defense of emergency preparedness needs. As you indicated, you concluded and at that time unequivocally that such divestiture would cause substantial harm to national defense and emergency preparedness telecommunication capability.

In addition to what you said today, do you see any indirect effects, such as research and development of new technology development and so forth, of this consent decree?

General HILSMAN. We might actually get a little bit of help in this area. Again, it goes to the competition.

I happen to believe that the Bell Labs are a premier laboratory for this nation, and they're a national asset. But there are some other folks out there today who are doing quite a bit of good work.

And I think the ability of the operating companies to not only deal with Bell and Western is going to put some pressures on Bell and Western to do a little bit better, because they're in a competitive arena.

I think that might be all right.

Senator SCHMITT. Are you suggesting that clones of Bell Labs may develop within the industry?

General HILSMAN. I think they're starting to develop today.

Senator SCHMITT. Do we have the national manpower resources to supply these with the same quality of people?

General HILSMAN. No. No, that's another issue I'm glad you brought up. We need that for a lot of reasons. We really need to upgrade our entire technological base of people in this Nation.

Senator SCHMITT. Does DOD have any specific plans in the telecommunications area, for example, to increase the availability in the national scale of these kinds of talents?

General HILSMAN. I've been asked by Dr. DeLauer, and I have a team working today with 101 leaders of our industry, with our military, ROTC departments, with schools now. We've just finished a pilot program in the Los Angeles area where we had 750 ROTC high school kids for a day at an engineering symposium. Yes, we're taking a lot of initiatives now to see if we can't do something—all the way back down through our school systems, to do a lot more.

Senator SCHMITT. But at the present time, in this and other areas, particularly in computer sciences, which is the core of the new environment for telecommunications, taken in aggregate, we're facing a 10 to 15,000 shortfall annually of advanced degree holders in these areas.

Do you agree with those numbers?

General HILSMAN. I would make it higher than that, sir. I would go up, Senator Schmitt, to tell you we're facing a shortfall of 50,000 to 60,000 a year.

Senator SCHMITT. If my calculations are correct, you're talking about a $4 billion to $5 billion investment annually in order to create that resource.

General HILSMAN. I'm talking about going all the way back into our public schools, where they've stopped——

Senator SCHMITT. I'm just saying if you were paying just for the advanced degree training of 50,000 young people a year, the investment is somewhere around $4 to $5 billion each year. And that's not an investment you would expect the Federal Government to make. It's an investment for the entire society.

General HILSMAN. That's correct. I agree totally with that.

Senator SCHMITT. So, even though you were arguing the competitive environment will improve, in fact, in the short term, there is potential dilution of the quality of research and development in telecommunications because of the shortfall in manpower?

General HILSMAN. Both the issues need to be worked extensively.

The CHAIRMAN. Senator Riegle.

Senator RIEGLE. Just on that point, because I think you're going to have to get more realistic or you're not going to be able to do anything in this country in a serious way, I have nothing against the efforts that you speak about that you're doing through ROTC and so forth. I think that's fine.

But if you're kidding yourself about the need to get your hands on the money to begin the serious training for people in the computer sciences and other things, you're going to end up finding yourself with lots of missions around the world that you can't fulfill. We're in that situation today.

I must tell you it really lifts my blood pressure when I see the Secretary of Defense, and presumably others in the Defense Department, calling for a doubling of the budget—the biological weapons, for example, nerve gas, and things of that kind—and yet really not stepping up to the question of bringing forward the kind of technical infrastructure within the military and within the society that it takes to be a leader in today's world. And we're sliding backward because we haven't faced that issue.

I agree with Senator Schmitt that we're talking about a commitment of national resources of something on the order of $4 or $5 billion a year, perhaps even more than that. We may disagree as to how much should or shouldn't come out of the public sector to get the job done. My concern is that we're moving so slowly and events are racing ahead of us so fast that by the time we wait for the trickle-down theory to work, in terms of bringing forward enough technical capability in this country, it's going to be too late.

So, I would hope that people, like yourself, who are in key spots will become militant enough about it to really try to force this issue and to get this on the radar screen of the President, to get this on the radar screen of the Ed Meeses and others who like to talk about major initiatives in our country without necessarily tracking through the question of capability and capacity, especially when it comes to technically trained people.

And the thing that worries me right now, we just can't wait for a situation to develop where we've got a major shortage and the price has been bid up for people in computer sciences and so forth. By the time that economic incentive works and starts creating the curriculums and pulling people on through the high schools into the colleges, we're going to be 10 years down the road and we can't waste those 10 years.

So, I would hope that on that issue—well, that's not what we're here to talk about right now, but it's been raised, so we ought to talk about it. It's going to take people like yourself, who are stubborn and tough and outspoken, within the military to get this focus where it belongs, on this kind of capability. Otherwise, we're not going to have the infrastructure.

And to me, it's absolutely analogous to the question of the telecommunications infrastructure here which you're concerned about. And that is if we don't have it, we can't use it when we need it. And the same thing is true with respect to the technical skills and capabilities in this country which we're short of and which we're not responding to.

So, I happen to have a very strong feeling about it, and I hope you know, to the extent that you do, that you will try to lead the charge as much as you can, short of getting yourself into hot water in terms of shoving this message up the line so that we start paying attention to the basics, because we're not doing it today. We're not doing it. I see it in the Budget Committee and the Defense budget. We're spending the money on the wrong things. We're not getting the capability that we need, and it's one of the reasons this country is sliding backward. And we're going to have to change that.

Let me ask you this. Were you included in the discussions on the settlement? Was the Defense Department a part of the active discussion and resolution of this by the Justice Department?

General HILSMAN. We weren't specifically included in the discussions on the settlement.

As I mentioned in my remarks, Senator Riegle, we were called over. I went over twice personally to meet with Mr. Baxter to be sure he and his staff understood our needs. And my staff worked with his staff in a great amount of detail after that to be sure they understood our needs. I believe they do. I believe that's why we have some of those words in there.

And I believe as we work over these next 6 months that, as well as they can, they will take care of them. I just don't believe they can take care of all of them without legislation.

Senator RIEGLE. Let me ask you about the part which concerns me most right now. That's the question of whether or not there might be sharp increases in local service rates that would cause disconnections, particularly among the elderly?

I'm hearing from them in increasing numbers, calling my office and so forth, and writing to me, because they're afraid if the rates jump up the way some estimates have said—for example, doubling or triping over a short period of time—they're not going to be able to afford it and, in effect, would be forced to make a tradeoff and disconnect their phone service.

If that happened, I assume it would be something that would concern you a great deal.

General HILSMAN. It would concern me as an American a great deal. It would also concern me as a bill payer. I pay all the bills. I contract for and pay all the bills for the Defense Department on all the telephone service that we order.

When we lost, in the Supreme Court about 6 or 7 months ago, the Telpak rates that we had; that is bulk rates, the government bill went up $100 million a year. That's a major issue for me.

With that organization that I have out in St. Louis, by the way, out in Scott, that does that, we're going to do an analysis of what we think it means to long distance rates, what we think it means to local rates. I don't have that yet.

Senator RIEGLE. Good.

Let me just say—my time is up—I would appreciate it if you could do what we've asked the Commerce Department to do—that is, an assessment of what you think is likely to be the impact on local rate increases and maybe under two or three different sets of conditions, so that if you saw a major increase in local phone rates which would lead to disconnections and reduced levels of service—I think it's important that we nail that down, you'll let us know what you find.

General HILSMAN. Fine.

The CHAIRMAN. Senator Danforth.

Senator DANFORTH. I don't have any question, Mr. Chairman.

I have the concern that all of these worthwhile potential law students might be diverted into something else.

Senator Schmitt and I were just talking about it. I absolutely share your concerns. I believe science and technology is so important to the concerns of this country, and we have to emphasize it; but that's not what you came here to testify about.

I really am concerned—and I say this as a lawyer, with absolutely no scientific knowledge—at the disproportionate quantity of people who are going to law school.

The CHAIRMAN. Absolutely all thinking of law suits to file against each other, to keep themselves busy in years to come. It's crazy.

Senator **Danforth**. If you can figure out an answer to it, let us know.

General **Hilsman**. I have devoted a great big part of my time to this issue, Senator Riegle, of taking it up, getting everybody in this nation concerned about the shortage of engineers and scientists. If you've got a free moment sometime, in your office, I'd like to come over and tell you what we're doing, because I can stand help, anywhere and everywhere, to get this thing done right.

Senator **Riegle**. You have an invitation.

General **Hilsman**. Thank you. I'll take you up on it.

Senator **Schmitt**. Mr. Chairman, just to let everybody know, the subcommittee of which Senator Riegle is the ranking minority member, and of which I am chairman—Science, Technology, and Space—of this full committee has made this one of its high priorities, if not its highest priority for examination. That's one reason why we have moved to try to get joint jurisdiction over NSF programs in this committee, so we can examine this very, very carefully.

We're eating our seed corn by hiring away our best and brightest baccalaureate degree holders, and we're shooting our farmers by hiring away their professors. And it is a self-defeating process that is driving us into the backwaters of technology and science. Even though we still dominate the Nobel Prize list, we have a tremendous inherent capability, the reservoir is running dry. If we don't have more perspective about the future than we have shown in the last 10 years—and when I say "we," it's not just the government; it's industry and the Department of Defense, every agency that depends on technological talent and scientific talent.

If we don't have more perspective than we've had about the future, then literally economic recovery will be aborted when it occurs, our national defense capability will be aborted when that recovery has gone its course, and we will be back right where we started.

General **Hilsman**. I agree totally.

Senator **Schmitt**. How did we get on that subject, Mr. Chairman?

The **Chairman**. Let me read into the record—Jack, this relates to the newspaper publishers. I found their testimony and wanted to be sure it's in this record, too, and I didn't misstate it earlier.

You had just finished asking some questions about Exxon's getting into the publishing business. And then Howard Cannon asked the following question of Mr. Marbut, who represented the American Newsaper Publishers Association:

> Senator **Cannon**. Now, to follow up on that, are you saying that anyone could provide that service, especially the newspapers?
>
> You don't want A.T. & T. to provide it?
>
> Mr. **Marbut**. Not in the markets where they've got the system. They can provide it in other markets. They can provide it in GTE's market, and GTE could provide it in their market. They could provide it over the cable system.
>
> Senator **Cannon**. Only where they have the transmission lines?
>
> Mr. **Marbut**. Only where they have the monopoly transmission.
>
> Senator **Cannon**. That they would be precluded?
>
> Mr. **Marbut**. Yes, sir.

The **Chairman**. Then I followed up on it a few pages later, as follows:

The **Chairman.** All right. So long as you can say anybody can package up those ads, whether it is in Joplin, Mo., or Portland, Oreg., or Las Vegas, Nev., big towns, small towns, whether they are weekly papers, daily papers, anybody can package them up but A.T. & T., and that is your position?

Mr. **Marbut.** That is our position, and only then and in only those markets where they have the transmission line. We are not saying that A.T. & T. should not do that in other markets..

The **Chairman.** I understand that. You've been very generous on that. GTE has the Los Angeles market and A.T. & T. could go there and go into the newspaper business and put ads on GTE's wires.

Mr. **Marbut.** Yes, sir.

We are still waiting for the attorney general, Assistant Attorney General Baxter, who is still on the stand. Is that correct?

I think we will take about a 15-minute recess, and if he cannot make it by then, we'll simply have to adjourn the hearing to some other time.

We'll take about a 15-minute recess now.

Senator **Schmitt.** Mr. Chairman, you might note we have a live quorum on now.

The **Chairman.** That will give us a chance to answer the live quorum.

We'll come back in 15 minutes and see if the Attorney General is available.

[The statement follows:]

STATEMENT OF GEN. WILLIAM J. HILSMAN, DIRECTOR, DEFENSE COMMUNICATIONS AGENCY

Mr. Chairman and Members of the Committee, I am here on behalf of the Department of Defense to comment on the impact of the Department of Justice-AT&T Antitrust Suit Settlement agreement upon the provision of telecommunications services to the Department of Defense. The Department welcomes this opportunity to reaffirm our previously expressed view that legislation is necessary to assure that our telecommunications industry, in concert with the government, can meet our urgent national security and emergency preparedness requirements. These range from the broad spectrum of natural disasters like hurricanes, floods, and earthquakes, to the deterrence of nuclear conflict, the management of crises to prevent escalation, the command and control of the strategic forces, the mobilization of our industrial base and the nation's manpower, the successful conduct of warfare, and the termination of hostilities and recovery of the nation.

When Dr. DeLauer and I testified before you on June 11, 1981, regarding Senate Bill 898, we urged that Congress, and not the FCC or the Courts, should establish the goals of and guidelines for national telecommunications policy, including national security, in the 1980's and beyond. We also supported legislative resolution of the appropriate future structure for the telecommunications industry. Since that time nothing has occurred, including the Justice-AT&T proposed settlement, which alters our view of the necessity to update the Communications Act of 1934. Indeed, when Dr. DeLauer and I apeared last June, we had already been studying, and preparing a DOD analysis of the effects upon national defense and security and emergency preparedness of the divestiture of the Bell System Operating Companies from the remainder of the Bell System.

In presenting our testimony and in preparing the DOD analysis of the impact of various forms of divestiture, our paramount concerns have been in the area of emergency response capability. From our national security/emergency preparedness perspective, to obtain effective emergency communications, it is absolutely essential that: (1) extensive preplanning and pre-emergency arrangements be accomplished; (2) that a robust and survivable nationwide telecommunications network be provided; (3) that the capability to manage and control the network so as to reroute and restore service be continued and markedly improved to meet the changing threat; and (4) that technical standards continually be developed and enforced so that all portions of the nation's telecommunications resources are capable of interoperation and universal connectivity. We feel that to the extent such capabilities currently exist, it is because of an entity that had the motivaiton, authority and technical and financial wherewithal to ensure that such actions occurred. For the past 65 years the Bell System, with the cooperation and support of the other common carriers, has been that entity. This has been dramatically demonstrated in every national defense crisis since World War I and in innumerable natural disasters. Today, with roughly 80 percent of the nation's telecommunications network provided by the Bell System, to include the vast majority of our defense communications needs, AT&T has taken the lead and has possessed the "clout" to develop the nationwide telecommunications system that has served us in peace and war and upon which we must build to meet our future emergency needs. The establishment of uniform, nationwide technical standards and operating procedures has also resulted from the integrated R&D, manufacturing, and local and long distance operations of the Bell System. These factors have led us to express our view that divestiture of major components of the Bell System, including structural separation between the local exchange and interchange functions, would impact system integrity and the Bell System's current ability to promptly provide emergency communications support and restoration.

Subsequent to our prior testimony and the completion of the DOD analysis, we have continued to review various past emergency responses of the integrated Bell System, potential future emergency needs, and the Bell System's current performance on our most critical U.S. Government communications. These historical reviews and gaming exercises have confirmed the national security and emergency preparedness value of the current common carrier and Bell System structure which can provide both interexchange and local exchange service on an "end-to-end" basis. Three examples will demonstrate what I mean.

In March 1975, an emergency of concern to general telephone users occurred when a Bell System switching office in New York City, containing one Class 5 switch and five Class 4 switches, was severely damaged by fire (Chart 1) depriving thousands of citizens of telephone service. The magnitude of the problem is depicted in Chart 2 attached to my testimony. The magnitude of the Bell System's response is best demonstrated by the vital statistics shown on Chart 3. As that Chart shows, nearly 4,000 people, including 1,250 from Western Electric and 25 from Long Lines and Bell Labs, worked round-the-clock to restore service in 23 days. Mobile-radio telephone units were also deployed from News Jersey Bell, Bell of Pennsylvania, New Englend Telco, and the C&P Telephone Companies to provide emergency service. The rapidity and effectiveness of the Bell System response was, in our view, directly related to its ability to marshal all available resources, from nearby operating telephone companies and the manufacturing, and long lines arms of the business, and to focus these resources upon the prompt restoration of service.

The value of this inherent emergency response capability of the integrated Bell System is further evident in the development of contingency plans for a potential large scale natural disaster such as a major earthquake. Under the provisions of the Disaster Relief Act of 1974 and in coordination with the NCS Operating Agencies, the Manager, NCS, has prepared a "National Plan for Communications Support in Emergencies and Major Disasters." This plan provides the basic managerial and operational structure for the telecommunications response to a catastrophic earthquake event. In preparing for this possible disaster, in 1980 the NCS performed an in-depth telecommunications assessment of what would be necessary if the State of California would experience a major earthquake. A review of the NCS data base of key communications facilities, concentrating on the Los Angeles and San Francisco areas which were identified as most critical, indicated that 34 key offices with supporting transmission facilities are located within a 55-mile radius in the Los Angeles area, and 50 such offices and supporting transmission facilities are within a 55-mile radius of San Francisco. Chart 4 attached to my testimony depicts these and other key facilities in relation to fault locations, and Chart 5 shows a summary of the common carrier communications switches contained in the 84 key offices surrounding San Francisco and Los Angeles.

As a result of that July 1980 analysis, NCS also determined that a high concentration of critical circuitry carrying high restoration priority assignments of national importance existed in the State of California (e.g., national warning systems circuitry, command and control circuitry). Two resultant observations made in the NCS assessment were that "restoration of federal government circuitry will be heavily dependent on the location" of any earthquake and that the "amount and level of residual communications and the capabilities of the commercial carriers for emergency restoral will be pacing factors which will govern the length of reduced communications from and to the impacted area." From this emergency preparedness contingency assessment, which was confirmed in a January 1981 Federal Emergency Management Agency report, it is obvious that the impact of any major earthquake would be much greater than the fire in the New York switching office, which contained only one Class 5, and five Class 4 switches. The Government is not, however, capable of providing anywhere near the necessary telecommunications response. Today, we would rely on AT&T to marshal national resources to do the job.

Finally, a recent analysis of the outage data on two categories of NCS Priority One circuits (i.e., those providing service to the most critical users in the Federal Government), demonstrates there is a significant difference in the frequency of outages and time for restoral on circuits provided exclusively by the Bell System and circuits provided by a combination of Bell System and other carriers. For the period February 1 through June 30, 1981, 98 separate Priority One circuits of the 1,179 such circuits provided in CONUS exclusively by the Bell System, were reported to our Operations Center as having experienced outages. The total number of discrete outage incidents associated with these 98 circuits was 302. For the 387 Priority One circuits provided in CONUS by a combination of Bell System and other carriers, 118 separate circuits were reported as having experienced outages, with 516 discrete outage incidents. This analysis indicates that 8.3 percent of the exclusively Bell System provided Priority One circuits experienced outages during the measurement interval, while almost 31 percent of the combination Bell System-other carrier provided Priority One circuits experienced outages. Furthermore, the total outage time for exclusively Bell System provided Priority One circuits was 1,326 hours, which equates to "down-time" of 3.1 percent and total resource availability of 96.9 percent. For the combination Bell System-other carrier circuits, the total outage time was 1,450 hours, or a "down-time"of 12.3 percent, with a total resource availability of 87.7 percent. These differences, on the Federal Government's most critical circuits, again demonstrate the national security and emergency preparedness value of the current Bell System structure which provides both interexchange and local exchange service on an "end-to-end" basis as well as a most robust rerouting capability. While I am not suggesting that other carriers cannot provide quality service, because they do, my point is that when we have to deal with more than one carrier, the problem is more difficult. As a Communicator for 28 years, I can verify the lesson learned here. "The less the number of people you have to deal with, the faster the response."

These three examples demonstrate that the integrated Bell System and the common carrier industry have been a national asset, providing substantial benefits to national defense and security and emergency preparedness. Furthermore, I cannot visualize the government developing the ability to replace this private sector capability which assures a nationwide telecommunication system and provides a rapid and effective response during times of crisis or disaster. We are, therefore, reviewing in detail the settlement agreement reached between the Department of Justice and AT&T to determine how it may impact on the means to ensure the continuation and enhancement of an effective emergency communications response capability.

Three provisions of the decree are pertinent to the concerns we at DOD have raised. They are:

The requirement that the Bell Operating Companies (BOC's) provide "through a centralized organization, a single point of contact for coordination of BOC's to meet the requirements of national security and emergency preparedness."

The provision permitting the BOC's to provide CPE for "emergency services."

The requirement that AT&T, Western Electric and Bell Labs provide "priority" support to the BOC's until September 1, 1987, to enable fulfillment of the requirements of the settlement.

These provisions are broad and do not specify how the residual AT&T structure and divested BOC's will coordinate their activities, or how they will relate to the government, other interexchange carriers and local distribution companies, for national security and emergency prepardness purposes. We, nevertheless, appreciate the obvious efforts of the Department of Justice to meet our national security and emergency preparedness needs. We are also heartened by the expressed commitments of the Chairman of the Board of AT&T that the Bell System will satisfy our national security needs through the provisions of this settlement. We anticipate that the reorganization plan to be submitted by AT&T to the Department of Justice will address these matters.

At this early stage of review, however, let me enumerate several specific points that need to be addressed and elaborated upon to ensure this settlement meets our needs:

1. Today technical standards for the industry are developed by the Bell Telephone Laboratories submitted to AT&T Headquarters and promulgated down to their 22 operating companies. These standards are also coordinated with the United States Independent Telephone Association (USITA). The integrity of the network is abso-

lutely dependent on the standards system. How will these standards be developed and implemented under this new structure?

2. In many emergencies of the past, such as hurricanes or floods, AT&T took equipment from one telephone company and gave it to another to meet the emergency requirements, and they did it fast. How will this get done under the proposed settlement? While the decree requires AT&T to provide the BOC's with "sufficient facilities, personnel systems, and rights to technical information" to permit the BOC's to provide exchange telecommunications and exchange access services, the settlement does not require the BOC's to provide any resources to the centralized national security/emergency preparedness "point of contact." Moreover, how will they fund for these resources? The settlement does not address the financial treatment of whatever BOC's investments and expenses are associated with this centralized entity. What is the probability that the various State regulatory commissions, when faced with increasing local service rates, will br receptive to any significant BOC financial or resource commitments for national security and emergency preparedness.

3. What is the definition of, and who decides what are "emergency services" for which the BOC's can provide CPE? In addressing S. 898 we urged that any telecommunications carrier should be permitted to act free from unwarranted restrictions in providing telecommunications facilities, services, or customer-premises equipment during times of emergency so that all such carriers could then provide an "end-to-end," complete communications link. Provisions to meet this need were thereafter included in the structural separation sections of S. 898. The provision of the Justice-AT&T settlement permitting the BOC's to provide CPE for "emergency services" would, however, only permit them to provide local service and CPE, and not an "end-to-end" emergency service that involved interexchange communications unless arrangements can be made with interexchange carriers. Thus, while today and under S. 898 we can turn to either AT&T Long Lines or a BOC to provide a complete "end-to-end" emergency communications link, under the settlement as written we could not obtain such a link from either entity absent those arrangements.

4. The provisions of the settlement directed at assisting the BOC's in developing the capability to independently provide exchange services and equal exchange access require AT&T, Western Electric and Bell Labs to give those BOC needs priority. How will this impact the priority emergency communications needs we seek to have AT&T, Western Electric and Bell Telephone Labs provide and how will conflicts in these priorities be resolved?

These are but some of the questions which need to be addressed and resolved in a manner that will preserve an effective "end-to-end" emergency communications response capability. We expect to discuss these issues with the Department of Justice and they have assured us they will be addressed in reviewing the details of the reorganization plan. Nevertheless, even if such questions are satisfactorily answered in the implementation of the settlement, our conviction remains strong that legislative modernization of the Communications Act is imperative. Indeed, in some respects this settlement increases the need for legislative action.

When Dr. DeLauer and I testified before you last June, we indicated the Department of Defense believed legislation in three broad areas was required to ensure this Nation's telecommunications industry would fully meet our national defense and security and emergency preparedness needs. First, we submitted that there must be pervasive recognition, in law, of the critical importance of the telecommunications industry to national security and emergency preparedness. The Justice-AT&T settlement does not and could not solve this problem.

Second, we stated that there must be legislative safeguards requiring all telecommunications carriers to engage in joint network planning and management, to develop plans and procedures for protection and restoration of essential telecommunications, and to prepare for the interconnection and interoperation of facilities and services when necessary to meet national defense or emergency preparedness needs. If the settlement is now implemented, it is probable that several additional major, non-Bell telephone companies will be created (i.e., the BOC's). Those sections of S. 898 which address Protection and Restoration of Essential Telecommunications and Network Planning and Management, and apply to all carriers, thus become even more significant.

Third, we indicated that Congress should legislatively resolve the appropriate future structure of the telecommunications industry to avoid subjecting all users to the years of uncertainty and turmoil resulting from different and conflicting regulatory and judicial initiatives. In our view, the settlement cannot assure that the regulatory framework of the industry will be consistent with the structure establshed by the settlement. For example, the FCC's Computer II decisions, which are based upon the regulatory framwork embodied in the 1934 Communications Act, including the interstate-intrastate jurisdictional split, clearly have not been overridden by a settlement which is premised upon a regulatory/deregulatory framework and an interexchange intraexchange jurisdictional split which do not yet exist in law. Legislative action is necessary to assure this consistency.

In conclusion, there are still many unaddressed and unanswered questions in this settlement agreement. We are working the details of these questions and will attempt to have the implementation plans address as many of these needs as possible. There is, however, no doubt in our mind that we need legislation to assure that this Nation's telecommunications system will meet national defense and security and emergency preparedness requirements. The settlement agreement simply does not and probably could never meet all of the significant concerns which have been the basis for our view that legislative modernization of the complex laws governing this nation's telecommunications industry is essential. We continue to urge the Congress to move forward to update the legal framework in which this industry operates.

Thank you for listening.

CHART 1.—*New York Fire*

Some vital statistics:

- 6000 tons of debris removed.
- 260 tons of underground cable removed.
- 600,000 pounds of air freight shipped.
- 10,000,000 relays cleaned by hand.
- 1.2 billion feet of wires placed underground.
- 8.6 million feet of cross-connection wire used, over 5 million wires of which were spliced underground.
- 570,000 feet of inside wiring cable used.

CHART 2.—*New York Fire*

Nearly 4,000 Bell System people, some from other parts of the country, worked round-the-clock to restore service in 23 days.

Personnel assigned:

Construction	1,197
Other New York Telephone	945
Western Electric	1,250
Bell Telephone Laboratories and A.T. & T. Long Lines	25
Outside contractors	538
Total	3,955

Mobile radio-telephone units were deployed from Bell operating companies in N.J., Conn., Pa., W. Va. and elsewhere in N.Y. to provide emergency service.

CHART 3

Switch class—Service	San Francisco	Los Angeles
5—Local service	168	230
4—Within metropolitan area	7	9
3—Sector-portion of State	5	4
2—Region-multistate	3	2
1—Nationwide	0	0

The CHAIRMAN. I have just been informed that Mr. Baxter will be in testimony for another hour.

So, we will adjourn at this time and reconvene subject to notice of the Chair.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

A.T. & T. PROPOSED SETTLEMENT

THURSDAY, FEBRUARY 4, 1982

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Washington, D.C.

The committee met at 9:30 a.m. in room 235 of the Russell Senate Office Building; Hon. Bob Packwood (chairman of the committee) presiding.

The Chairman. The committee will come to order.

This is a continuation of our hearing on the A.T. & T. settlement. Attorney General Baxter was scheduled to testify last week, but he was also scheduled to testify at the same time before the Judiciary Committee. The Judiciary Committee kept him from about 9:30 until 1:30, and he couldn't stay any longer, so he graciously agreed to come back today. He is our only witness today on the subject.

I have no opening statement. Senator Pressler, do you have any?

OPENING STATEMENT BY SENATOR PRESSLER

Senator Pressler. Well, very briefly. I would first like to commend the chairman for calling these hearings in a timely and expedited fashion. I contacted the chairman immediately after this agreement had been announced to express my concern about the predicted results of this decision. I am, therefore, extremely pleased that the members of this committee have had the opportunity to assess the long-range effects of this historic agreement. The past 5 years have demonstrated that the results of deregulation are not always beneficial to rural States like my home State of South Dakota. For instance the promised advantages of airline deregulation have not materialized for my State. Instead, we are in the middle of a difficult transition period and must work to find replacement air service for our towns and rural communities at affordable prices.

South Dakota's experience with transportation deregulation has caused me to look at deregulation of the telecommunications industry with some caution. Throughout the congressional debate on this complex issue I repeatedly expressed my fear that basic telephone rates would rise as a result, particularly in rural communities.

S. 898 contined provisions that guaranteed reasonable rates for local telephone service. I believe these hearings are a good forum to discuss how this divestiture agreement meets the goals of S. 898 and what legislative action needs to be taken at this point. As one who voted in favor of S. 898, both here in the committee and on the Senate floor, I am on record as a supporter of competition in the telecommunications industry. It is my hope that this agreement between A.T. & T. and the Justice Department will encourage a more competitive atmosphere while at the same time guaranteeing the maintenance of universal telephone service at reasonable rates.

I might conclude by saying that I'm very concerned about what is going to happen in small towns and rural areas—I know there are many assurances being given—but in particular, both in the interests of our national communications system and in the interests of citizens living in these smaller areas. And those comments I would address to my fellow members of the committee as well as to both the Justice Department and A.T. & T. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cannon.

OPENING STATEMENT BY SENATOR CANNON

Senator CANNON. Thank you very much, Mr. Chairman. I want to begin this morning by saying that I believe that Mr. Baxter should be ousted from his job as the result of this settlement.

Mr. Baxter, this morning the Post quotes your predecessor, Sanford Litvak, as saying that the A.T. & T. settlement is more favorable to the Government than any he had proposed when he was in your position. Last week Charlie Brown convinced us that the settlement was overwhelmingly in the best interests of A.T. & T., its customers, and its employees. Now given this praise for your efforts, it's clear to me that you're in the wrong job. You should be in charge of the Federal mediation between Donald Regan and David Stockman.

There's an old adage in Washington, "No politician has ever lost popularity by criticizing the telephone company." After reading the record of last week's Commerce Committee hearing and seeing the accounts of the House hearings, I'd say that there must still be considerable truth in that saying. Well, I for one certainly don't want to be left out of the popularity contest, so I want to go on record today as officially charging Ma Bell with providing inferior service at inflated prices. And having now made by obligatory criticism of the phone company, I have a confession to make. I am impressed with the proposed settlement between the Justice Department and A.T. & T., and I actually believe that in the long term it may be in the public interest.

For years we've been arguing about potential legislative remedies to the telecommunications issues facing us. We've been told by countless parties that what we really should be doing is separating A.T. & T.'s monopoly functions from their competitive functions. We were also told that such a solution, while desirable, would be impossible, politically. As a result we've agonized with all sorts of schemes to divide A.T. & T. in some other way. Each proposal seems to be even more awkward and cumbersome than the last. Now we're faced with the prospect of precisely the solution that has been advocated so hard by A.T. & T.'s competitors and potential competitors for years. It seems that we should try to make it work not try to destroy it.

Of course, we must be sensitive to the impact on local user rates, and we should do everything possible to minimize the impact on the local users, but we must not lose track of the fact that we're faced with an opportunity to launch the telecommunications industry on a historic path of meaningful competition and greatly enhanced development of service and technologies. We must recognize that we have the chance to end a decade of uncertainty about the future of Government regulation of the telecommunications industry. And most importantly, we must be bold enough to look far into the future to see what is in the best interests of this country as it strives to maintain pace with developments in other parts of the world.

It seems to me to be irresponsible to suggest that simply because A.T. & T. is a willing party to the agreement that it must be bad. I commend the competitors of A.T. & T., such as MCI and SP Communications who didn't take such a knee-jerk position. They, of course, want to see the details of the plan; so do I. But these companies truly believe in competition, so long as it's done on an equal basis, and it's as much to their credit for sticking to that position.

Now before we kill this proposed settlement in the press and in congressional hearings, let's look long and hard at the alternatives. Can we ever hope legislatively to achieve such a significant splitting up of A.T. & T.? Do we really want to see the continuation of years of litigation before the antitrust suit is finally settled? Is there any better way of putting all competitors on an equal footing? And who has a better idea?

Well, I, for one, want to commend Assistant Attorney General Baxter and A.T. & T. for developing the outlines of a settlement that has tremendous potential. There are many details to be filled in. I want to pursue some of these in detail with Mr. Baxter today, but the basic outline that we've seen so far is very encouraging. The proposed settlement makes the split, where economic theory and common sense say it should be, between the inherently competitive functions and the inherently uncompetitive functions of A.T. & T.

It has consistently been argued that A.T. & T.'s monopoly ownership and control of the local loop makes it impossible for potential competitors to gain access equal to that enjoyed by A.T. & T. itself. There is no more effective way to prevent such practices than to break up the ownership of the local loop, and that's what's being proposed, and we'd be foolish to lose the opportunity to do so.

I happen to agree with the prudent comments of Senator Goldwater in last week's hearings. Let's stop and take a good look at this proposed settlement, before going off the deep end. Legislation may be desirable, but we have to learn a good deal more before we can responsibly begin such a process. In the meantime, we should be examining the details of the settlement and encouraging the final product that best meets the public interest.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Howard.

Mr. Baxter, go right ahead.

STATEMENT OF WILLIAM BAXTER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. BAXTER. Thank you, Mr. Chairman. I have submitted to the committee a prepared statement, which I understand will be included in the record. It explains in some detail the situation of the industry immediately prior to the settlement of this case, the basic provisions of the 1956 decree holding the A.T. & T. system to the provision of regulated telecommunications services, and the basic procedural aspects of the settlement—why it was that we chose to get this whole set of problems in front of one court in the particular way we did, namely, by filing the agreement as a proposed modification in the New Jersey court and moving in the New Jersey court to have that case transferred down to Washington, and so on and so forth.

Those details, I think, are familiar to most of you now, and I would not propose to go over them again. I'd be happy, obviously, to answer questions.

I would say only this, that the case is now precisely in the posture in which I wanted it and tried to get it. It is before Judge Greene, who is very, very knowledgeable about this industry because of his experience in trying the 1974 case. There will be hearings on the decree that track the procedural requirements of the Tunney Act, and Judge Greene has essentially the same powers with respect to the proposed modification of the 1956 decree that he would have had if we had chosen slightly different procedural avenues for the settlement of the case.

I suppose, although I'm happy to be corrected and redirected if I'm wrong, that what the committee would primarily like to talk about today is the proposed modification itself, what the telecommunications industry will look like in the future, how it would be affected by this decree, how the regulatory powers of the FCC and the local public utility commissions are affected. And I would propose to make some comments on those matters.

As Senator Cannon has very rightly said, the basic thrust of the decree is to separate the natural monopoly functions of our telephone system off into a group of regulated enterprises. They will be regulated primarily by the State public utility commissions. In certain respects, the Federal Communications Commission, too, will continue to have a role. Obviously, the regulatory powers of the Federal Communications Commission cannot be affected directly by anything we were able to agree to with the A.T. & T. Co., and the effects on the local public utility commissions, too, will be very slight and indirect.

On the other hand, the proposed modification does change very, very important features of the industry which they regulate in important ways. A.T. & T. Co., after the decree is approved and the reorganization occurs, will be, for the most part, an unregulated, intensely technological and, I believe, a very vigorous competitor in a large number of markets going far beyond the markets in which A.T. & T. has heretofore participated. That, I think, was one of the highly desirable features of this decree. We have released the enormous technological potential of this very outstanding company to participate in electronics, competitive telecommunications, on a worldwide basis, information transmission and a variety of other activities.

The A.T. & T. Co. will continue to own and operate the long lines division, and the long lines division at present and in the immediate future will continue to be regulated by the Federal Communications Commission. That may seem like an exception to the proposition that the regulated segments have been separated from the unregulated segments, but in a very important sense, it is not an exception.

Again, as Senator Cannon very rightly observed, it is the inevitably and appropriately regulated sectors of their activity that have been broken off from the potentially competitive sectors. There is nothing about the long lines business in most markets in the United States which makes continued regulation inevitable. Long lines transmission of messages is, to a substantial degree, and will be, to an even more substantial degree, a perfectly—I shouldn't use the word "perfectly," because the next word is "competitive," and that's not what I mean—workably competitive industry.

In the short term, A.T. & T. will continue to have a very large market share of that business, but one must not confuse a large market share with a position of significant monopoly power. Although A.T. & T.'s competitors in the long-distance transmission business at present have very, very small market shares, they are expanding those market shares very rapidly. Some of the most important of those competitors have virtually been doubling their market share each year. A.T. & T. will be able to continue to hold a very large market share of this long-distance business, if, and only if, it renders very high quality services and renders them at competitive prices. Any attempt, without regard for regulation, any attempt by A.T. & T. to exploit the large market share of long-distance services which it now has by charging prices above competitive levels will result in an exceedingly rapid erosion of its market share by a substantial set of healthy and technologically vigorous competitors.

In short, I foresee in the relatively near future the potential for substantial deregulation of Long Lines functions.

There will, of course, continue to be thinly populated portions of the United States where A.T. & T. is likely to hold a measurable degree of market power for some period of time. It's difficult to make confident predictions about that. Alternative technologies will press very hard on A.T. & T., even in these contexts. When it was true that long-distance message transmission was possible only through cables, there were economies of scale in thinly trafficked markets that do not continue to be present, when microwave is an alternative technology.

My own guess is that, even in the thinly trafficked portion of the country, competition for long lines transmission will be very intense within 5, 6, 7 years, and the total deregulation of the long lines function is a very realistic possibility.

To be broken off from this surviving piece of A.T. & T. about which I have been talking, are the local operating companies. Unlike the long lines function, the provision of local telephone service is one of the best known examples of what economists refer to as a natural monopoly. Having pulled one set of wires through the streets and into our homes, the cost of pulling a second and parallel set of wires would cause it to be true that prices would be higher with two companies than with one. There is nothing to be gained from competition under these circumstances, and that is precisely what makes regulation appropriate. Not only do these basic operating companies face cost and demand conditions which cause us to characterize them as a natural monopoly, but it is a natural monopoly of enormous economic power. And what I mean by that is that the demand curve for the service, the amount that people would be willing to pay, if they had to, to avoid giving up the service, the demand curve lies loftily above the cost curve that confronts the supplier of those services. In short, if the service were not regulated, there is an enormous potential for monopoly profits to be earned of staggering magnitudes.

The function of regulation in such circumstances is to insure that the results of competition are mimicked as best as may be—and that's none too good—by the regulatory process; in short, that the service is rendered efficiently and that the prices for that service are held down to a level roughly commensurate with their costs. That is a function that the local public utilities commissions in the main will be performing.

Their ability to perform that role is wholly unaffected by the decree. The concern that these enterprises will not be viable is amusing to anyone that understands the cost and demand relationships. So, far from being unviable, these companies could, in the absence of regulation or with regulators permitting, earn an enormous stream of excess profits.

The problem is not with their viability. They will be viable, so long as the local public utility commissions do their jobs well. The local public utility commissions, of course, like any other regulatory agency, can destroy the companies they regulate by not permitting them to earn rates that are high enough to replace the necessary equipment which they utilize in the provision of their services, but there is no question whatsoever about the viability of these companies, setting the quality of regulation to one side.

Under the proposed modification of the 1956 decree, the assets of the present A.T. & T. Co., will be divided essentially into two piles. Into one pile will be put all those assets, all those switches, all that wire, all those service trucks and trained service people, that are necessary to perform the local exchange service, including the origination of long-distance messages within the local exchange, and the termination of long-distance messages within the local exchange. It is not difficult to identify that equipment, and everyone clearly understands that that equipment is to go into that pile.

Other equipment and other personnel will go into the other pile, and the agreement defines with some precision exactly where the local exchange function stops in equipment terms. The local exchange function includes all the local loops, the class 5 or end offices, and it includes all the local tandem switches and the trunks leading to them, and it includes the trunks leading up to the class 4 switches. And that's where the local exchange function stops, at the wall of the class 4 switch.

Now, that terminology may sound complex or puzzling to people who are not familiar with the industry, but it is well defined. There is no large, open ambiguity about what equipment goes in what piles.

Now, let me turn to some of the adverse comments I've heard about the decree and try to explain why, in my view, they rest on some misunderstanding of what the situation is.

First of all, it is said that the profits of long-distance telecommunications have, in the past, flowed into and cross-subsidized and kept down the price of local telephone service, and that that situation will now come to a halt, with the consequence that local telephone rates will have to go up. That is not true in at least one sense, and I think probably two senses, although I am not prepared to be quite so dogmatic about the second sense as I am about the first. Let me take the second first.

It is not at all clear to me that long lines' revenues presently perform any cross-subsidization function with respect to local rates. To insist that they do overlook several important factors. At the present time the local operating companies pay what is called a license contract fee to the parent A.T. & T. Co. This is a percentage fraction of their revenues that is conceived as having the purpose of reimbursing the A.T. & T. Co., for the value of research done by the Bell Laboratories, and for a variety of central corporate functions—pension fund management, payroll functions—performed by the general division of the A.T. & T. Co. It is my view that that license contract fee is too large and that it has been a path through which the A.T. & T. Co., has siphoned out of the local operating companies revenues that ought to have stayed there.

The license contract fees will be halted by the decree. Those funds will stay with the local operating companies. So one must take that phenomenon into account in deciding whether, looking at the whole picture, A.T. & T. and the long lines division has in any sense been subsidizing local telephone service.

A second factor must be kept in mind. In the past the local operating companies have been under very considerable pressure, I'll put it that way, to make their equipment purchases from Western Electric. This, of course, is one of the matters that was in dispute in the lawsuit, and like other matters in dispute, was not formally resolved by any findings of fact. But it is my view that the basic operating companies have been paying unnecessarily high prices for the equipment they bought from Western Electric. After the reorganization is in effect they will no longer be required to buy their equipment from Western Electric. They will be able to buy it competitively from whomever offers them the best quality at lowest prices. There is another fund flow from the local operating company to the parent company, which I at least argue will disappear with this reorganization.

I now come to a third and more visible fund flow that goes in the opposite direction, and it is this fund flow that people have in mind when they talk about cross-subsidization. And now I refer to the division of revenues between the long lines division and the local operating companies, on account of long-distance service.

The local operating company, of course, sends out the bill and collects the money for long-distance service as well as local service, and that money has to be divided in some way between the local operating company and the long-distance company. That division purports to be based on cost allocation. Cost allocation is a very uncertain process. Under most circumstances, most particularly including this one, what is involved is something of the following kind: a large amount of equipment exists at the local level; the very same equipment that originates and terminates local calls either originates or terminates, but not both, long distance calls. How do you allocate the costs of local plant as between the long-distance function and the local exchange function?

Historically, that cost allocation has occurred through a process called separations, and it is perfectly true that in this process the A.T. & T. long lines segment of the business has been more than generous to the local operating companies, and the fraction of long-distance revenues which has been retained at the local operating company has been generous, resulting from a generous attitude in the way one allocates these costs that I've referred to. And that is the so-called subsidy for local rates. But it is not at all clear to me that the fund flow in the direction of the local operating company that results from this cost allocation process is substantially more than or perhaps more at all than the funds that flow in the other direction through the license contract fee and the purchase of equipment. That is the sense in which I say the proposition that local rates will go up is arguably wrong.

I now turn to a consideration which, independently and without reference to the matter about which I've been talking, I say flatly and dogmatically makes the statement wrong. In the agreement with A.T. & T. there is provision for access charges. In the future the local operating company will impose charges on long-distance carriers, through these access charges, for the service of either originating or of terminating long-distance calls within the exchange area. Those access charges are subject to the regulation of the local public utility commission on intrastate calls, intrastate long-distance calls, and they are subject to the regulation of the Federal Communications Commission on interstate long-distance calls. And those regulators have the authority to set those access charges wherever they choose to set them, and there is not the slightest doubt in the world that if they wish to do so, they can set them high enough to recapture for the local companies precisely those revenues that would have been received through the separations process under the old way of doing things.

We know the financial wherewithal is there, after all. The local companies have been getting that all these years, and the regulators could continue to capture exactly the same fund flow for them through the use of these access charges, or they could capture more or they could capture less. But that is a matter for the regulatory commissions that are in place. The proposed decree merely creates the vehicle of the access tariff. It does not set its level. That is left to the regulating commissions.

There are two other items that I would like to take up. One is the controversy over the Yellow Pages. The proposed decree treats the Yellow Pages as an information service. It says, in effect, that the Yellow Pages go to the surviving A.T. & T. Co., rather than to the operating company, and that in a sense is true. But one must not think of the Yellow Pages as a monolithic entity. It is not. The process of preparing the yellow pages, selling the advertising that they contain and distributing the Yellow Pages is a very complex set of activities, and it has different portions, and I propose to disaggregate them into several different portions.

Most of those activities are competitive. There is no natural monopoly phenomenon associated with selling advertising space; hundreds, if not thousands of enterprises throughout the United States sell advertising space. Nor is there any monopoly feature associated with printing or trucking the books back to the communities where they will be used. These are all very competitive activities.

Why, then, is there any huge revenue stream? Why is there anything more than a competitive profit associated with putting out the Yellow Pages at all? There is a big profit there, but why is that? What is the critical control factor that enables a monopoly profit to be earned in association with the Yellow Pages?

There is one. It is the exclusive possession of a machine readable, up-to-date listing of the names, addresses and phone numbers of local businesses. That's what creates a position of exclusivity that allows a monopoly profit to be made. And who has that? The local operating company has that and it will continue to have it. That does not go to A.T. & T., so that the unique scarce asset that enables a monopoly return to be earned by reason of publishing the Yellow Pages remains in the control of the basic operators.

Now, they can do with it what they will. They can give it away. They can license it to three or four different publishers of Yellow Pages. But there is another possibility, too. They can auction it off to the highest bidder, essentially sell off the right to be the exclusive publisher and distributor of the Yellow Pages. The Yellow Pages go to A.T. & T. only in the sense that A.T. & T. will have a hunting license, will have an opportunity to be the highest bidder for that machine readable list of local telephone numbers.

A.T. & T. will derive a stream of revenues, of course. It would not bid and neither would anyone else if it could not fully recapture a competitive return on its investment in that competitive business. But all of the monopoly revenues that are associated with the Yellow Pages are left to the basic operating companies and can wholly be captured by the basic operating companies if they will simply auction off the exclusive right to publish the Yellow Pages.

In short, the proposition that the local operating companies are losing revenue that is associated with the Yellow Pages is entirely wrong. They are losing the competitive revenues that are fully offset by costs. But there is no reason on Earth why they should lose the monopoly revenues, and it is only monopoly revenues that are capable of cross-subsidizing something else. Other revenues are offset by their own corresponding costs.

The last item about which I would like to say a few words is the question of customer premises equipment. The provision of customer premises equipment is a potentially competitive activity. Indeed, in a long series of cases, starting with the Carterfone decision years ago, we have been taking the position that this was a competitive activity. There are other suppliers of customer premises equipment. It should be a competitive activity. If it really were a competitive activity, on the other hand, there would only be competitive returns to be made. The local operating companies should be indifferent to whether competitive equipment was left in their portion of the enterprise or transferred to A.T. & T. In either event, it would generate revenues only commensurate with the costs of maintaining it.

The real fight is not, the controversy here is not, about customer premises equipment (CPE) in general. It is about customer premises equipment that is already in place, so-called embedded CPE. In our view, the only way to make the CPE industry competitive is to transfer that embedded CPE, along with all other CPE activities, to the competitive sector. Why is it that the public utility commissions would like it to stay? The only reason they can have for wanting it to stay is because they expect to generate a revenue stream higher than its costs. And that can only be true if, in some way, they propose to perpetuate monopoly conditions and monopoly prices for CPE, at least for embedded CPE, at the local level.

There are two possibilities, really. One possibility is that they will simply—recognizing now the dimensions of all that equipment that will have to be replaced, it will not last forever, it will become technologically obsolescent, if nothing else. They could simply set depreciation rates too low, essentially cannibalize and in some senses confiscate that equipment, by not providing for its replacement, since it's become a competitive market and capture those corresponding funds as a device for further subsidization of local telephone calls.

Another possibility is that in some sense they will cooperate with the basic operating companies so as to put other competitors at a disadvantage. They will become aiders and abettors to a future section 2 violation, by which the control over the local loop will be used to monopolize customer premises equipment.

Neither one of those approaches seems at all satisfactory to me. The States, of course, have devices readily available to them to cause the demand for customer premises equipment to subsidize local telephone bills, if they wish. They could, for example, impose an excise tax on sales of customer premises equipment or a use tax on ownership of customer premises equipment within their boundaries and pay the proceeds to subsidize local telephone rates, if they wished to do that. That approach, as a practical matter, would operate uniformly on all suppliers of customer premises equipment. It would not interfere with the competitive process in customer premises equipment, and would have much different and much less economically harmful effects on that market than the other alternatives.

In short, there may be some substance to the position that leaving customer premises equipment with the local operating companies will, in a sense, generate some funds that could be used to cross-subsidize local phone bills, which would be taken away, if embedded CPE, as well as all other CPE, is transferred to the A.T. & T. Co. But one should recognize the nature of the fund flow that we're talking about. It can derive only from a perpetuation of monopoly conditions with respect to that equipment. It can derive only from a continuation of exactly the section 2 offense that the 1974 case was brought to terminate.

And I would not think that was an appropriate way to go about the process, however desirable it may be, of holding local phone rates down.

Thank you, Mr. Chairman, that completes my statement. I'd be happy to respond to any questions the committee may have.

[The statement follows:]

STATEMENT OF WILLIAM F. BAXTER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

I am happy to be here today to discuss the recent actions of the Department of Justice regarding the *AT&T* case. As you know, on January 8, 1982, the Department and AT&T filed an agreed-upon modification of the 1956 Consent Decree in *United States* v. *Western Electric and AT&T*, and stipulated to dismissal of the Government's monopolization case filed against AT&T in the District of Columbia in 1974. The decisions to take these actions were clearly the most important that I have made as Assistant Attorney General. The dispostition of these matters are not only of great antitrust significance: they are also most significant to the work of this Committee. I appreciate fully the interest of the Committee in them.

The way in which we have moved to resolve our antiturst controversies with AT&T is one that I hope will be widely recognized as promoting competition in the dynamic telecommunications industry and as doing so in the most efficient way. While the modified Decree does not, and is not intended to, resolve all of the regulatory or legislative issues that may exist in telecommunications now or in the future, it does do what an antitrust decree should in these circumstances—eliminate the key structural barriers to the emergence of effective compeititon in the industry.

We had two litigation fronts open with AT&T, one involving a 25-year-old Decree that recently had been interpreted in a way that had substantial competitive ramifications, the other involving a monopolization case brought by the Government seven years ago, the trial of which was nearing completion. The restructuring of AT&T to which we have agreed, and the accompanying injunctions, resolve both of these controversies.

The 1956 consent Decree was entered in settlement of an antitrust case filed in 1949 in New Jersey by the Department of Justice. That case charged AT&T with monopolizing the manufacture and distribution of telephone equipment in violation of the Sherman Act. Although the complaint in the 1949 case sought, among other things, the divestiture of Western Electric, the 1956 Decree did not require that divestitute. Instead, the 1956 Decree contained various restrictions on AT&T's activities, including limiting AT&T to providing "common carrier communications services," the rates for which are subject to governmental regulation. The premise underlying that restriction, I think, has been that absent such structural relief as would effectively eliminate AT&T's incentives and abilities to monopolize, confining AT&T to its traditional regulated common carrier communication businesses would ensure against AT&T subsidizing the provision of unregulated services and equipment with revenues derived from its regulated monopoly activities.

In September 1981, the U.S. District Court in New Jersey interpreted the 1956 Decree as permitting AT&T to offer certain equpment and services even though the rates for such equipment and services would not be subject to regulation. AT&T sought this interpretation after the FCC, in its 1980 *Computer II* decision, allowed AT&T to offer such equipment and services through fully separated subsidaries. The Department appealed the district court's interpretation, but in conjunction with its agreement with AT&T on modification of the Decree moved to have the appeal dismissed.

Under the modified Decree, all of the provisions of the 1956 Decree would be eliminated and replaced by provisions requiring AT&T to undertake an 18-month reorganization, after which the Bell operating companies providing local exchange telephone services will be divested by AT&T into one or more companies. AT&T will continue to own a nationwide intercity network composed of its Long Lines Department and the intercity facilities of the Bell operating companies, and will retain ownership of Bell Telephone Laboratories and Western Electric. AT&T will also provide customer premises equipment, including that now furnished by the local Bell companies. AT&T's plan for the required reorganization is to be submitted to the Department of Justice for approval within six months of the effective date of the modified Decree.

The modified Decree also requires the to-be-divested operating companies to provide, on a phased-in basis, exchange access to all intercity carriers equal to that provided to AT&T, and forbids the operating companies from discriminating against AT&T's competitors with respect to procurement, interconnectin of equipment or services, the establishment and disclosure of technical specifications, and the planning of new facilities and services.

Let me explain the reasons for our seeking this modification. Any successful effort to establish a truly competitive telecommunications industry must prevent a dominant regulated carrier such as A.T. & T. from frustrating the emergence of competition, particularly in telecommunications equipment, intercity services, and related information markets. A.T. & T.'s control of regulated local monopolies has enabled it to dominate intercity service and telecommunications equipment markets. Through its ownership of exchange monopolies serving 80 percent of the nation's telephones, A.T. & T. has controlled facilities essential to any firm attempting to challenge Long Lines or Western Electric.

The most straightforward and effective way to eliminate A.T. & T.'s incentives and abilities to exclude competition from potentially competitive telecommunications markets is to require the divestiture of its regulated local exchange monopolies from those portions of A.T. & T. that engage in competitive and potentially competitive activities. That is precisely what the reorganization required by the modification does. Divesting ownership of local exchange facilities from intercity facilities will eliminate the incentive and ability of a joint provider of local and intercity services to discriminate against other providers of intercity services when such services must rely at some point upon the local distribution network. Similarly, the divested regulated operating companies would not have incentives to discriminate in favor of Western Electric and against other suppliers of telecommunications equipment. Because the divested operating companies may, for a period of time, retain some institutional loyalty and as a result of inertia continue to favor prior affiliates, the modified Decree establishes basic equal access and nondiscrimination requirements to backstop the reorganization in promoting competition in intercity service and equipment markets.

The divestiture of A.T. & T.'s regulated local exchange monopolies that is accomplished by the modified Decree obviates the need for the restrictions that the 1956 Decree placed on A.T. & T. Without its base of regulated local exchange monopolies, there is no longer the same need to worry over the long run about cross-subsidized forays into unregulated markets and, therefore, no reason to restrain A.T. & T. from entering such markets. To the contrary, enabling an enterprise with tremendous skills and resources to enter unregulated markets should increase competition and the pace of innovation in those markets.

We also believe that the modified Decree provides a frame-work for satisfaction of the concerns of the Department of Defense. Since early spring of last year when Secretary Weinberger, appearing before the Senate Armed Services Committee, indicated his concerns over the relief sought in the 1974 *A.T. & T.* suit, we have had numerous meetings and discussions with DOD officials to discuss the specifics of our proposals and for us to learn their specific national security concerns. Under the modified Decree, national defense benefits from an integrated Long Lines, Western Electric, and Bell Labs will continue. In addition, the modification contains specific provisions to ensure continued centralized coordination among local Bell operating companies to meet national security and emergency preparedness needs.

Many have speculated that the restructuring required by the modified Decree will necessarily lead to sharply higher rates for local telephone service as subsidies from long distance revenues are removed. In fact, the Decree itself will have no effect. The current subsidy system would have been subject to some pressure from competition in long distance service in any event. Moreover, there is nothing in the modified Decree that would prevent federal or local authorities from generating a local service subsidy through local exchange access regulation. Indeed, the issue of whether to continue such subsidies is presently being reviewed by a joint federal-state board under the auspices of the FCC.

Agreement upon the modified Decree made it unnecessary to continue litigating the Government's 1974 monopolization case against A.T. & T. That case alleged that A.T. & T. had monopolized certain telecommunication services and equipment markets. Trial began in early 1981 and was scheduled to resume on January 12 and be concluded in February. The reorganization achieved by the modification of the 1956 Decree is nearly identical to the relief that had been sought by the Department of Justice in the 1974 litigation, and, together with the injunctive provisions in the modification, substantially achieves the purpose of the 1974 case. Accordingly, the Government and A.T. & T. stipulated to dismissal of the 1974 case without prejudice.

Concern has been expressed about the procedures to be followed in connection with the entry of the modified Decree. It is and always has been the intention of the Department, and A.T. & T., to follow the procedures of the Tunney Act in this matter, in order to allow opportunity for comment by others and a complete exposition of the modification's merits. The Decree will require a basic restructuring of the telecommunications industry, and thus necessarily affects vital public concerns. While we believe that the Tunney Act does not by its terms apply to modification of existing decrees, most of which involve minor adjustments of concern only to the immediate parties, the Act's procedures and standards can help facilitate thorough review of major decree modifications. Accordingly, we have followed comparable procedures in connection with major decree modifications in the past.

It has also always been our intention to follow the Tunney Act procedures here in the District of Columbia. We believe that Judge Greene, who as a result of the trial of *United States* v. *A.T. & T.* has substantial expertise in the telecommunications industry and the effects of restructuring, is uniquely qualified to make the determination that the modified Decree is consistent with the public interest. Therefore, upon filing the proposed modification in the U.S. District Court in New Jersey, the Government and A.T. & T. moved to have jurisdiction over the 1956 Decree, and any proceedings relating to its modification, transferred to the District Court in Washington.

As the Committee knows, the District Court in New Jersey unexpectedly entered the modified Decree on January 11. While we appreciated that Court's view of the merits of the modification, we remained committed to thorough review in the District of Columbia using Tunney Act procedures. On January 14, 1982, Judge Biunno entered an order transferring the matter here. On January 21, 1982, Judge Greene, to whom the matter has been assigned, vacated the order entering the Decree and set out the procedures—identical to those of the Tunney Act—that he intends to follow. We intend promptly to take the steps required by Judge Greene's order. In short, we are following the Tunney Act path that we have intended to follow all along.

Finally, it is obvious that the changes in industry structure to be brought about by the Decree will have to be taken into account in assessing the need for and content of pending or future telecommunications regulation or legislation. Complex regulatory provisions designed to guard against anticompetitive cross-subsidization by AT&T are probably no longer necessary. There may be other issues not so directly related to competition that deserve regulatory or legislative attention—for example, the question of whether or how to subsidize local telephone service in a competitive environment—but I would defer comment on such matters at this time.

Mr. Chairman, this concludes my prepared remarks. I will be glad to address any questions you may have.

The CHAIRMAN. Mr. Baxter, I want to make sure I understand the legal process involved in consolidating the cases under the Tunney Act provisions. Do I understand that Judge Greene has, in essence, announced that he will follow the equivalent of the Tunney Act provisions so that there's ample time for comment from various public utility commissions and others who are interested?

Mr. BAXTER. That is what we asked him to do, Mr. Chairman, and I understand his response to be that, yes, he will do that.

The CHAIRMAN. What is that time limit? How long will the parties have?

Mr. BAXTER. We have a period of time in which to file a competitive impact statement. I think it's 20 days or something, perhaps 30 days. It's not very long. Then there is a window, I believe, of 60 days during which parties have to file comments of any sort. The judge can hold hearings.

The CHAIRMAN. Is this after the 60 days he holds the hearings?

Mr. BAXTER. He has a great deal of discretion, really, to proceed almost as he wishes, but opportunity for comments and provision for hearings is made in the legislation.

The CHAIRMAN. But if he wanted to go beyond that, he has the judicial power to do so and give local utility commissioners time to prepare whatever brief they wish to prepare?

Mr. BAXTER. I'm sure; yes.

The CHAIRMAN. Next question. What happens at the end of all this, if Judge Greene does not agree with the consent decree? Does he have the unilateral power to modify it as he wants, even though the case was never terminated with both parties presenting their sides?

Mr. **Baxter**. He has the unilateral power to reject the proposed modification as not being in the public interest. He does not have the unilateral power to modify it and then enter it. It represents an agreement between the parties. He, of course, has the power, if power is the right word, to indicate to the parties that he is not willing to enter it in one form and suggest that they change it in certain respects. And the parties would be hard put to refuse to make changes that were reasonable, in view of the fact that the judge has the power to refuse to accept the decree.

The **Chairman**. If he refuses to accept it and the parties will not change, what then are the options of the parties and of the judge? If he won't accept it, do you have the power to say simply, "We're not going ahead any further," and the case simply remains in limbo?

Mr. **Baxter**. Yes; that would be a power that would be available to me. One consequence of that, of course, is that the 1956 consent decree would remain in effect, and A.T. & T. would be confined to regulated telecommunications markets.

The **Chairman**. I'm just speaking of powers now. You would have the power, obviously, not to go ahead. Does the judge have any rights to appoint any other attorneys to continue to prosecute the case, if he is dissatisfied with your unwillingness to proceed?

Mr. **Baxter**. There is no case. There is only the 1956 consent decree at this point. Another power which you have not yet alluded to would be our power to file a new section 2 case against A.T. & T. which looked very much like the one we filed in 1974, essentially resume litigation in Judge Greenes' court of the kind that was terminated several weeks ago.

The **Chairman**. But does he have the right, absent your consent, to appoint other attorneys to continue the prosecution of the Government case?

Mr. **Baxter**. No; he does not.

The **Chairman**. Does not. So under the worst circumstances, you would reach a place where he would not agree to the settlement that you and A.T. & T. had agreed upon. You would not go forward, and the case could be in limbo?

Mr. **Baxter**. That's a conceivable possibility. It seems quite unlikely to me.

The **Chairman**. I want to go back to the Yellow Pages and the rights of the local companies. While the local companies, I understand, do not have the technical right to put out Yellow Pages under this consent decree, they do have the right to sell information to half a dozen local competitors who might want to put out something in competition with the Yellow Pages.

Mr. **Baxter**. Or to one.

The **Chairman**. Or to one. They can sell it to anybody who wants it. And as a matter of fact, my hunch is, that's what's going to happen. You're going to see a fair number of local competitors competing for the publication of the equivalent of Yellow Pages. Call it what you want.

Mr. **Baxter**. I fully expect that myself.

The **Chairman**. And the local operating companies are the only ones who have the information that would make a competitive service possible. So it's in their interest to sell it to as many competitors as will buy it.

Mr. **Baxter**. It's in their interest to sell it to the highest bidder.

The **Chairman**. Or sell it to four or five bidders. There's no reason they have to sell it to one.

Mr. **Baxter**. That's true.

The **Chairman**. The reason I'm saying that is, I can picture a situation where some local competitors might be interested in publishing only the equivalent of the yellow pages restaurant section or the Yellow Pages auto section. They're not interested in getting into other businesses.

Mr. **Baxter**. That's true. The local numbers are often sold for the purpose of specialized directories. I rather doubt myself, although I could turn out to be wrong, that there will ever be more than one inclusive yellow page listing, and I would expect myself that the LOC's would find it in their interests to auction off to some one highest bidder the right to publish the inclusive listing, and then perhaps auction off to another the right to publish a restaurant specialized set of Yellow Pages, another an automotive specialized, and so on and so forth.

The **Chairman**. There's nothing at all in the proposed consent decree, nothing, that prohibits the Joint Board from going on with the policy of separations, and settlements; isn't that right?

Mr. **Baxter**. That's an awkward question. I mean, the existing process of separation and settlements contemplates a single ownership situation. The decree really does contemplate that it will be displaced by—and I think does explicitly say that the local operating company is to receive funds that derive from long distance service only through access charges. In that sense, it does contemplate an abandonment of the settlements and separations process as we have known it in the past and a use of access charges in lieu of that.

The **Chairman**. All right. Let me pursue that question. It has a very important effect on local rates. Is there anything in the consent decree that prohibits the Joint Board from setting as high a long distance access charge as they choose to do?

Mr. **Baxter**. No.

The **Chairman**. And if they in their policy, or if we make it statutory by passing such a policy that we are going to continue the long distance-to-local subsidy. There is nothing in the consent decree that prohibits the Joint Board from increasing the access charges, or for us to do it statutorily in addition to your decree, is there?

Mr. **Baxter**. Absolutely not. The decree imposes an obligation on A.T. & T. and the basic operating company to file cost based tariff proposals, but that is merely an obligation on the part of the private company and not any constraint on the regulator. And of course, they must be equal for all long distance categories.

The **Chairman**. Now the present law is that local public utilities commissions set intrastate long distance rates. Is there anything in the consent decree that changes that?

Mr. **Baxter**. No.

The CHAIRMAN. So within a State, whatever State it may be, if the local public utility commission wants to decide it is imperative to keep rural and residential rates down as far as intrastrate long distance rates are concerned, they can set that access charge at whatever they want.

Mr. BAXTER. So long as they treat all long distance carriers equally.

The CHAIRMAN. The difference is that now you're going to have A.T. & T. on the side of MCI and Southern Pacific and others wanting to keep those subsidies down, because they're no longer part of the operating companies.

Mr. BAXTER. That's correct. In that area, they're a competitive enterprise seeking the business of the local exchange companies.

The CHAIRMAN. Senator Pressler.

Senator PRESSLER. As I mentioned earlier, deregulation in such industries as the airlines has not been beneficial to rural areas such as South Dakota. This divestiture promises to increase competition. However, promises made during the discussion of past deregulatory efforts have not always materialized for rural States.

I would like your comments on what this agreement will mean to rural America. Specifically, what effect will this agreement have on the price of long-distance calls between smaller towns? I come from a town of 450 people, Humboldt, S. Dak. We, and all other South Dakotans are very concerned about the long-distance and local rates.

Also, what incentive will there be for unregulated carriers to bring new technologies to sparsely populated areas?

In short, I have two questions—one, the price of long-distance calls between smaller towns, and two, the incentives for new technology in sparsely populated areas.

Mr. BAXTER. Well, first, Senator, lest it be supposed that I am acquiescing in any way with your comments about airline deregulation or trucking deregulation, let me say that every study that has been conducted by responsible observers of which I am aware—and I have seen a number—has found that the rural areas on the whole—I have seen none with respect to South Dakota, so I would not want to speak to that situation individually—that there is more and better service to the rural communities after airline deregulation than there was before.

Senator PRESSLER. I welcome you to come with me on my next trip to South Dakota and fly around with me.

Mr. BAXTER. I've seen none on South Dakota.

In answer to your question, this proposed decree would have no effect whatsoever, for better or worse, on small communities such as the one you described. The cost of service to those communities is what it is. The rates, by and large, are below cost.

One kind of cross-subsidization that we know is occurring in the telephone industry is the cross-subsidization of low-density routes by the imposition of implicit excise taxes on the high-density routes. So there is a cross-subsidy that is now keeping the costs of telephone service in very small communities below their costs.

As I have said, the provisions for access charges which the proposed decree makes places it within the power of the regulators to continue that process of cross-subsidization or increase it or decrease it as they wish.

They may change their minds in the future about the extent of the cross-subsidy, that it's appropriate, that it is too large, that it is too small. But the decree will not affect that.

Now, let me say something else. Competition over time will drive prices to equal costs. That will occur if this decree was not entered. It will occur if S. 898 was passed. It will occur if S. 898 weren't passed. That is one of the important functions of competition, to drive price toward cost.

At the present time, as I say, the densely populated routes tend to cross-subsidize the thinly populated routes. Within a reasonably short period of time, 8, 10, or 12 years, most certainly within most of our lifetimes, microwave technology, and perhaps a combination of laser and microwave technology, will destroy much of the natural monopoly phenomenon that characterizes telecommunications.

It will be possible to use small rooftop antennas that can tune in on any one of six telephone companies in town. As that process occurs, the prices on the densely used communication routes will have to come down, because if they do not come down, the local telephone companies will be bypassed with open media transmission mechanisms, such as microwave or laser or something else.

And as competition from rival technologies drives those rates down, they will cease to have the potential to cross-subsidize the thinly used routes. So that in the long run the cost of telephone service in your hometown, it's going to have to carry its own weight, unless the legislature there chooses to levy an explicit tax on some other activity in order to cross-subsidize it or to cross-subsidize it directly out of the Treasury.

In short, what I am saying to you is that in the absence of some explicit legislatively authorized subsidy over the next 10 years, the costs in your small town for telephone service are going to go up. They are not going to go up because of this decree. The decree leaves them totally unaffected.

Senator **Pressler**. Mr. Chairman, I have two followup questions which I will submit for the record if I may.

The **Chairman**. Thank you.

Senator Cannon.

Senator **Cannon**. Thank you, Mr. Chairman.

Mr. Baxter, you say the next consent decree itself will have no effect on local rates. Now, some state regulators are talking about rates doubling or tripling.

Given the size of the industry, that sounds to me like a hundred billion dollar misunderstanding—in round terms, the difference between a balanced budget and the deficits that we now face. Would you care to comment on that difference of opinion? I don't mean the budget difference, but the other.

Mr. **Baxter**. Senator Cannon, I think it's a misunderstanding between the statements that rates are going to go up, which is a correct statement, and a statement that rates are going to go up because of this decree. There isn't any doubt that rates are going to go up. Rates are going to go up for several different reasons—local rates.

First of all, to the extent there's inflation, they're going to go up in nominal terms.

Second, technological change at the local telephone service level is no longer very high, and we know there is an inevitable economic process by which price adjustment occurs in the society, with the price of things experiencing rapid technological change tending to fall and things experiencing little technological change tending to rise, even in zero inflation conditions. So local telephone service will go up for that reason.

Furthermore, to the extent there is cross-subsidy present, it is going to be driven out by the threat of being bypassed by alternative technologies with the passage of time.

So, it is true that local telephone rates are going to go up, but they're not going to go up as a result of this decree.

Now, if your job is to do the best you can to keep local telephone rates down, if it is true that your political future in some sense depends on keeping local telephone rates down, and if you can foresee that local telephone rates are going to go up, it's nice to have something to blame it on.

So there may be a certain amount of looseness of statement here that has found the decree a convenient vehicle in that respect. But I submit that if you really look at the decree and look at the provision there for an exchange access charge and understand the industry, you understand not as a matter of prediction, but just as a matter of logic, that the decree is not going to affect local telephone rates.

Senator CANNON. Now, while the outline of the settlement looks sound, the specifics remain to be worked out. And the details that we don't know yet include such important matters as how assets are to be valued and how many new operating companies will be created.

First, let me ask you when you expect the detailed plan to be agreed to by the Justice Department and A.T. & T.?

Secondly, would you address the issue of how many operating companies there are likely to be?

Mr. BAXTER. The A.T. & T. company has, at the outside, 6 months following the entry of the decree within which to submit their plan for reorganization. It may, of course, proceed more quickly than that. I think it will proceed more quickly than that. I would think we would have a plan of reorganization certainly within this calendar year, and I hope well within the calendar year. But that's uncertain.

It is conceivable that hearings with respect to the proposed modification could drag on for a considerable period of time, and then A.T. & T. would take its full 6 months. I'm not in a position to make any promises in that regard. But this is a company which I think wants to get going at this point, and I expect them to move more rapidly.

How many operating companies there will be I don't know. I don't know how many there should be. A.T. & T. has every incentive in the world to bring into existence a group of operating companies that maximize the value of the properties that they have, which will be efficient, well managed. After all, it's own shareholders are going to wind up owning those operating companies. They constitute about two-thirds of the assets that those A.T. & T. shareholders now own. And if they are bundled improperly, it is going to impair the value of those properties in the hands of the shareholders, and it may provoke shareholder suits.

I am really prepared, at least in the first instance, to leave the question of how many operating companies, 5, 10, to A.T. & T. If they came in with companies that seemed to me of doubtful viability, if they came in with 49 or 50 operating companies, including Rhode Island Tel, I would not think that was in compliance with the decree.

So, I don't have a very direct answer to your question, how many operating companies, nor I guess to the question when will we see the reorganization. But I would like to say a word about the process of valuation to which you refer.

The process of valuation has nothing to do with the reorganization. The reorganization will put physical properties on one side of the line or another. Some physical properties will wind up over on the regulated side of the line. The local public utility commission will now come along and say, "Well, that's a different pile of assets than we used to regulate. We are going to have to redetermine the rate base of the company we regulate." That's what valuation means.

Valuation is an accounting process by which a regulator assigns accounting numbers to physical properties. The reorganization will not speak to the valuation question. We will not speak to the valuation question. Valuation will be something that is done by the regulatory agencies after the reorganization is complete, and their discretion in performing the evaluation function is entirely unlimited by the decree.

Senator **Cannon**. You indicated that you wouldn't expect that they would go—or that you would approve 49 companies or 50. What about the other end of the scope? What about one company?

Mr. **Baxter**. I'm not sure that one company would pose a problem. I don't think that's what A.T. & T. intends to do. Some people have expressed concern that only one company would be in possession of—"enormous buying power" is the expression used—monopolistic buying power, I gather. That clearly isn't true, and the reason it's not true is because the kind of things that the LOC's, the local operating companies, would be buying are not sufficiently differentiated from things that other people buy.

In short, even a single operating company would be buying in competitive markets, and the people who produce switches and the people who produce computers, the people who produce communication cables and other kinds of cable are not sufficiently differentiated. There is no set of productive assets or resources that is captured and has no place to sell except to the local telephone companies.

So I would not be greatly alarmed by a single operating company. I'd prefer to have two or five, but I would not see that as a major problem. I know others have suggested that it would be a problem.

The **Chairman**. Senator Ford.

Senator **Ford**. Thank you, Mr. Chairman.

Mr. Baxter, you referred, in your last answer to Senator Cannon, that A.T. & T. should be very careful as it relates to the division in order to protect the ownership or the stockholders of A.T. & T.

How, in your view, would the stock be divided or transferred if you had one operating company? Would it be stock into one operating company or half in A.T. & T.? Or if you have five operating companies, then how would that stock be divided in order to maintain the strength of the ownership of that stock? Can you help me a little bit, please?

Mr. **Baxter**. Yes, I think so. Without intending in any way to rigidly foreclose exactly how A.T. & T. does it, I'm sure the process will work about as follows. It's what is referred to as a spinoff in the corporate reorganization world. And basically what A.T. & T. will do is to form, let us say, five new operating companies, five regional operating companies around the country as corporations. And they will issue stock. And because the day before the reorganization, the final step in the reorganization, A.T. & T. owns those five companies, A.T. & T. will hold five piles of stock, one in each of the operating companies. And then it will cause to be printed up some new A.T. & T. shares, which we'll call "A.T. & T. New Company"—have some of those stock certificates printed up.

And it will say to the shareholders,

> Now, shareholders, please send us your old stock certificates in "A.T. & T. Old." And as soon as we get your stock certificate in "A.T. & T. Old," we will send you a replacement stock certificate in "A.T. & T. New," and we will also send you five new stock certificates, one in each of the operating companies.

So the day after the reorganization a person who had been a shareholder of "A.T. & T. Old" will wind up being a shareholder in six companies, in each of the operating companies and in "A.T. & T. New." And his percentage interest in those real income producing assets out there will be entirely unaffected by the process. He will own exactly the same percentage interest in every single switch and every single paper clip the day after reorganization that he owned before, but will have some very different looking pieces of paper in his hand.

Senator **Ford**. Some of those operating companies are not quite as profitable as others within the system. What happens to the stockholder who gets his certificate in the unprofitable area rather than taking the whole?

Mr. **Baxter**. Well, everyone is going to get a certificate in each of the operating companies. Now, the day following the reorganization, trading will open up on the New York Stock Exchange, and I assume that all these companies will be traded on the New York Stock Exchange. But if not, on the American. I don't care about that.

And now a separate value will come to attach to operating company No. 1, a different value to operating company No. 2. And let us say that operating company No. 2 has, as you tell me some of them have been, historically been a low earner. Presumably the share price of operating company No. 2 will fall. Or indeed, the moment trading opens, it will open at a value below the value that is associated with No. 1.

Senator **Ford**. But yet I've been given a share in that low profitmaking company.

Mr. **Baxter**. Also one in the higher one, and one in every other one. So the day after trading opened, you look at the trading price in company No. 2, and you say gee, that trading price still seems high to me in relation to the profits of trading company No. 2, so you"l sell it and the price will be driven down even further until people who hold that share are just happy to hold it at the given price at which it was being traded on the exchange.

Senator **Ford**. Very quickly, Mr. Baxter, it seems we have a hard time getting some questions in. What will A.T. & T. have to do with the company they have? Say they have 25 percent of an operating company like the Washington, D.C. telephone company. A.T. & T. owns 26 percent of it.

Mr. **Baxter**. They won't have to do anything in particular with it.

Senator **Ford**. They still keep the 25, 26, 28 percent. That becomes part of the new company?

Mr. **Baxter**. The decree does not require them to do anything in particular.

Senator **Ford**. All right. The bell didn't go off too loud, so let me ask you one quick one, and this will be my last one, Mr. Chairman.

In your CPE, the basic operating companies keep, in my opinion, an increasingly obsolete system. Each of those companies will keep an increasingly obsolete company over the years because you have referred several times to new technology. The cellular mode system which will soon be on the market, that belongs to A.T. & T. new, as I understand it.

Has A.T. & T. in this decree given to these operating companies the obsolete operation and kept unto themselves the new technology that everybody will want? And have you then imposed by this decree on those companies increasing obsolescence and increased costs to the residential owner?

Mr. **Baxter**. No, I don't think so at all. There is, of course, a sense in which everybody who owns a plant, if there are any technological changes occurring at all, owns an increasingly obsolescent facility. Then presumably, when he replaces that plant, he builds a brandnew, up to date technological plant and then he again owns an increasingly obsolescent facility. And in that sense, of course, the local operating companies will own both increasingly obsolete facilities. But as they replace them, as they are depreciated, they will replace cross bar switches with stored program electronic switches and they will keep up with the technology in the same way any other industry keeps up with the technology.

Senator **Ford**. Thank you, Mr. Chairman.

The **Chairman**. Senator Hollings?

Senator **Hollings**. Thank you, Mr. Chairman.

Mr. Baxter, I generally approve of the direction in which you are going, because we called for that in a bill which we introduced some 4 years ago. The misgiving of Senator Pressler is not a spurious one. I respectfully dissent from your so-called responsible studies on airline deregulation.

What the airlines did—not just in a rural State like Senator Pressler has, but also in a medium-sized State like my own—was take that same equipment and start flying the more profitable routes like Atlanta to Las Vegas and Houston to Seattle. Then they didn't have to serve Savannah and Charleston and Norfolk. They could close those stations and lay off the ground crews and everybody else.

Each day now I see the airlines travel over my home on their way from Washington to Miami for $77, and I'm paying $132 and they're getting to Miami quicker than I can fly from Washington to Charleston, because I've now got to go through Charlotte. So my service is worse, my cost is higher. Let's forget about the responsible studies. I mean, there's got to be that consideration of service to the rural areas and the medium-sized areas as you fashion this divestiture.

Now, with respect to long distance and local telephone service I never have, in all the work that this committee has had in this particular field, been able to determine which is subsidizing the other.

The CHAIRMAN. Let me ask you a question. What happened to your Air Florida direct flight?

Senator FORD. They closed that up.

Senator HOLLINGS. He bit.

I knew one of them would come up, because actually that was taken over by Pan Am and then they closed it. You want to go into the airlines. We had a sweetheart deal and we were getting the best of service. Now the airlines are going broke. You've got better service to Las Vegas and other places like that.

In any event, who is subsidizing? Do you find in your work in this particular field that the long distance has been subsidizing the local or the local the long distance? I'm wondering. I've never been able to determine.

Mr. BAXTER. I think if one goes back far enough, it's quite clear that long distance did tend to subsidize local, residential. Local business also, I think, tends to subsidize local residential.

Senator HOLLINGS. But the long distance is the separating point, long distance from local. So we can look then for an increase there, you would say, as a result of divesting the long lines service?

Mr. BAXTER. No. My point is that long distance has come under competition in recent years. Long-distance rates have tended to come down quite sharply. They've also come down, of course, because of technological change and cost reductions on long distance. But I think the level of subsidy has fallen, and indeed it may have disappeared completely. At this point I think it is hard to say.

Senator HOLLINGS. I see. Going to Senator Ford's question relative to the technology, do you feel in administering this divestiture proceeding that we, let's say you and I, the ratepayers, have any interest whatsoever in Bell Labs? In other words, do you think just as a matter of stockholders? I never have looked at the A.T. & T. stockholders as normal stockholders because there was no risk. They were guaranteed a return, and all we had to do was look at the profits they make.

I just wish we all had the opportunity to put money in it because it was a no-risk situation, and I feel as a ratepayer, and you as a ratepayer, all of us in this room have somewhat built up Bell Labs. And does that just go totally from us in the divestiture?

We in the local service areas, the local operating companies, are we going to get any advantage from Bell Labs? What is your feel and approach there with respect to that billion dollar operation, the most magnificent research facility in the entire world? I feel like I sort of helped build that, and I know how the trust lawyers and how the stock lawyers talk. I've been one of those, too. I am wondering, now, with relation to the fairness of us having built it up as ratepayers, what share are we going to get of that Bell Labs?

Mr. BAXTER. Well, we will all continue to derive considerable benefits from Bell Laboratories. That's because I would expect Bell Laboratories would go on doing the very, very good science that it has always done and that does benefit everyone. On the other hand, it is legally true that the shareholders of A.T. & T. own all of the assets of A.T. & T. They own the regulated assets; they own the unregulated assets.

If you have in any sense helped build Bell Laboratories, it is as a customer, the same sense in which I have helped build General Motors. But that doesn't mean that I own their factories or any part of them. No. Bell Laboratories will, and in my view, should be owned by the surviving A.T. & T. Co.

Senator HOLLINGS. You weren't guaranteed a profit in General Motors. You were guaranteed a profit in A.T. & T.

Mr. BAXTER. The only sense in which I was guaranteed a profit in A.T. & T. is by the fact that, as I said earlier, the demand curve lies way, way above the cost curve, and that's what induced us to regulate it. If we did not regulate it, its profits would have been much higher. But risk also would have been much higher.

There is a sense in which regulation, by depressing price below the demand curve, that is leaving a big cushion up there where costs can be recovered by the increasing price, does greatly reduce risk. Of course, the securities markets have never regarded A.T. & T. as a riskless stock. The risk premiums on A.T. & T. stock have been higher than Government bonds, for example, whether that seems right or not.

The CHAIRMAN. Senator Schmitt?

Senator SCHMITT. These days it may seem right.

Mr. Chairman, again I think we ought to compliment you for getting through these hearings so quickly. I want to thank Mr. Baxter for joining us.

Mr. Baxter, I do, however, have to admit to some professional antagonism toward you. The consent decree, as I am coming to understand it, seems to have totally ignored Congress; in particular, what has been going on in the Senate. It appears to have ignored much that has been going on in the FCC. It also has ignored the Department of Defense's wishes on the subject. Why, if you will, have you been so totally self-centered on the issue?

Mr. BAXTER. Because this is an antitrust case, and our primary responsibility was to solve the antitrust problem. The decree does solve the antitrust problem.

Senator SCHMITT. There was no other solution available; is that correct?

Mr. BAXTER. There was an infinite variety of solutions available.

Senator SCHMITT. That could have taken into account the will of the people expressed through their elected representatives?

Mr. BAXTER. There was no way the decree could do what S. 898 did, if that's what you're referring to.

Senator SCHMITT. Why?

Mr. BAXTER. Because we did not have the authority to change the jurisdiction of the Federal Communications Commission.

Senator SCHMITT. Then why didn't you wait? Why didn't you let the Congress work its will?

Mr. BAXTER. And what were we supposed to do in the meantime? Just continue the spurious litigation, and 6 months or 2 years from now say we didn't really mean it? We really quit back in January 1982?

Senator SCHMITT. That was one alternative open to you. There were others.

Mr. BAXTER. The others don't occur to me.

Senator SCHMITT. Well, even if you have developed a decree that we can live with, you have developed a great deal of antagonism toward the Justice Department as a result of the actions, not only of the consent decree, but previous actions that have affected the deliberations of this committee. I don't speak for anyone but myself, and we're going to try to make this thing work if, in fact, Judge Greene decides to let us. But I hope that in the future you and others in the Justice Department will recognize that there are basic responsibilities within the Congress that supercede those of the Justice Department.

I don't think you really explored the alternatives that were available to you to move in a direction at least consistent with what was happening here on the Hill. I really don't. I know you feel that way, but I personally do not.

Mr. BAXTER. I have no idea what other alternatives you have in mind, Senator, so I can't respond very well.

Senator SCHMITT. Apparently you can't. That's what bothers me. It appears that right from the beginning, you went into this with a single-minded idea about the way it ought to come out, and you have forced every other party, including the Congress, to follow along that course. And I, frankly, don't think that was necessary. I think a much more open mind at the beginning, a recognition of what the interests of what our national defense are, a recognition of what the interests of the local communities are, as discussed by Senator Pressler and others, what the total interests of the people are in this case might well have taken you along a different path.

Mr. BAXTER. I suppose we may have different views about some of those things. It's quite true that I view the appropriate resolution of this case as the divestiture of the monopoly aspects of A.T. & T. from the potentially competitive aspects. That's what I wanted at the beginning and I am very pleased with the result.

Senator SCHMITT. I figured that you are, but it is not what the Senate had decided to do. You recognize that, I presume.

Mr. BAXTER. The Senate is free to overturn what I have done by legislation.

Senator SCHMITT. We are free by legislation to overturn what you have done by decree.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gorton?

Senator GORTON. Mr. Chairman, I am sorry that I have not been here for any significant portion of this hearing. I would certainly be willing to be corrected if I ask questions which have already been covered.

Do I understand from your exchange with Senator Schmitt that you now believe no legislation to be necessary or desirable?

Mr. **Baxter**. No, I certainly didn't mean to suggest that at all, Senator.

Senator **Gorton**. Certainly, of course, this decree impacts on the legislation which has already been passed by the Senate.

Mr. **Baxter**. Most certainly it does.

Senator **Gorton**. And is being considered in the House. Have you made specific recommendation as to how that legislation should be modified?

Mr. **Baxter**. No, I have not.

Senator **Gorton**. Do you intend to do so in the foreseeable future?

Mr. **Baxter**. Neither I nor the Department of Justice will make any legislative suggestions. I would expect that the administration may have legislative suggestions.

Senator **Gorton**. So in that sense, what you said to Senator Schmitt was correct; the entire gamut of problems relating to the size and the monopoly position of A.T. & T., as they have impelled Congress to act at this point, have been taken care of by this decree, assuming it's approved by the courts?

Mr. **Baxter**. No. I certainly did not regard all of the problems that were addressed by S. 898 as having been solved by the decree. The Communications Act of 1934 is, after all, half a century old. It pertains to an industry where there has been extremely rapid technological change. I would think that we would wish to continue about the business of updating the Communications Act, and there are many aspects to that problem.

But the decree does not and could not conceivably touch—neither the Antitrust Division nor the Federal courts have authority to revamp the FCC as it might appropriately be revamped after this half century, and so the decree does not touch many of the problems that were addressed in S. 898, could not, should not, hasn't tried to do so. So it still seems to me quite likely that legislation by the Congress, with respect to the telecommunications industry, would be entirely appropriate.

Senator **Gorton**. Nevertheless, the structure of the FCC's relationship with this corporation obviously had a tremendous impact on the course of this litigation. In spite of that fact—are you saying the Department of Justice simply will not be making any recommendations to Congress? Does that mean that you will not be making any recommendations to the administration in connection with its position?

Mr. **Baxter**. Certainly not, no. We will be working very actively within the administration on the proposal that takes into account the now altered face of the telecommunications industry.

Senator **Gorton**. When do you expect the administration to have a position to offer?

Mr. **Baxter**. I really do not know.

Senator **Gorton**. During this Congress?

Mr. **Baxter**. I would expect so.

Senator **Gorton**. One other question on a detail of your settlement. There has been criticism, as you are well aware, that the operating companies now inherit the least advantageous and potentially least profitable portion of A.T. & T.'s business. While A.T. & T. is relatively happy with the settlement, it goes largely unregulated in the future. Could you explain to me why it is in the settlement that the Yellow Pages, the directory services, were left with A.T. & T. rather than being the province of the individual operating companies?

Mr. **Baxter**. I explained that, what I fear was a tedious thing, before you came in, Senator. There is one critical aspect of publishing the Yellow Pages to which all of the supercompetitive profit is attributable, namely the exclusive possession of an up-to-date, machine-readable listing of the names and addresses and phone numbers of all local businesses, and that unique asset is left with the basic operating companies. Only the competitive aspects of the Yellow Pages which earn only the competitive rate of return have been transferred to A.T. & T.

In short, to whatever extent it was possible for the Yellow Pages to cross-subsidize local telephone rates in the past, it will, in my view, be possible in the future.

Senator **Gorton**. Thank you.

Thank you, Mr. Chairman.

The **Chairman**. You indicated that with the advent of microwave or laser or cellular mobile transmission, long-distance rates will have to come down because you will have heavy investments poured into transmission and not use local access connections at all. There is nothing, however, unconstitutional, is there, about the Federal Government levying a charge on the use of the air space to subsidize local rates?

Mr. **Baxter**. I certainly know of no basis for supposing there is.

The **Chairman**. Simply because we move into that area of transmission via other than the wire doesn't mean we cannot continue the subsidy if we choose to.

Mr. **Baxter**. Heavens, no. Certainly not.

The **Chairman**. Let me ask you a personal question: Do you think we should continue the policy of subsidy?

Mr. **Baxter**. I would say yes—but in a much more limited and pinpointed way than has been the case in the past. I can see a very strong case for what I would call lifeline service—to people of very, very limited means; to people who are ill and may have to call a doctor; or even people in remote locations who basically want an emergency connection with the outside world.

That kind of telephone service, limited perhaps to three outgoing calls per month, or something of the sort, I think might be subsidized very, very extensively, and quite reasonably.

The general subsidy—to residential users, to people making several hundred thousand dollars a year, as well as people making $10,000 a year—the general discrimination against local businesses whose excessively high phone bills are simply reflected in grocery prices, for example, seems to me of very doubtful wisdom.

The **Chairman**. That's not a philosophy we follow, however, in transportation. Most of the highways in this country today don't pay their own way. If we were really to go on a utilitarian basis, most of rural America simply wouldn't be connected with each other by highways.

What's the difference in communications?

Mr. BAXTER. One difference is feasability. It would be very difficult to implement the general attitude I'm reflecting about limited and pin-point subsidies in the highway system. It's very easy to do so in the communications system.

The CHAIRMAN. When you say "easy"—maybe if we were to go into the income tax returns, everybody who makes over $15,000 will have $1 a month subsidy; if they make over $18,000, it's $1.50. If you consider the number of telephones in this country, that is easier said than done, I think, in terms of management. If that's what you're thinking of.

Mr. BAXTER. I just had in mind creating a lifeline rate.

The CHAIRMAN. To which only certain people would have access, based on what?

Mr. BAXTER. The nature of the service would be such that anybody, including me, if all the telephone service I want is a single instrument, limited to making three outward calls per month, then I, too, would be entitled to getting it for $1 a month, or whatever.

The CHAIRMAN. Let me change the subject.

The modified consent decree allows A.T. & T. to go into the cable business, cable television?

Mr. BAXTER. Yes. Or the automobile business, or any business.

The CHAIRMAN. In essence, any business that they were not specifically precluded from, they could go into?

Mr. BAXTER. Yes.

The CHAIRMAN. Whereas the local companies, in essence, are precluded from going into anything except the local transmission of calls, or the interacting of long distance lines?

Mr. BAXTER. That's substantially correct.

The CHAIRMAN. But you think even with that, left with only that, the local companies can be viable?

Mr. BAXTER. I have absolutely no doubt of it.

The CHAIRMAN. And be viable by charging prices that reasonable people would regard as reasonable?

Mr. BAXTER. I would say yes, as a matter of definition.

The CHAIRMAN. I have no other questions.

Jack?

Senator SCHMITT. Mr. Baxter, how do you answer the Department of Defense's concerns that, although this may be workable, it is second best?

Mr. BAXTER. No one from the Department of Defense has said that to me.

Senator SCHMITT. It's been said in front of this committee.

Mr. BAXTER. The Department of Defense had an opportunity to look at the proposed modifications before final agreement was reached. I was informed that their concerns had adequately been taken care of.

Senator SCHMITT. What if they had said what they said to this committee in formal testimony—that they preferred the system the way it is?

Would you have changed your proposed decree?

Mr. **Baxter**. I would not have known what to do with such a cryptic message.

I am sure that A.T. & T.——

Senator **Schmitt**. Do you consider S. 898 a cryptic message?

Mr. **Baxter**. No. That goes on at some length. No.

I would have to have sat down and seen what the remaining difficulties were that the Department of Defense had with the proposed modification, before I knew how to discharge my own responsibility.

Senator **Schmitt**. Then you are saying that, in contrast to what this committee has been told, the Justice Department was not informed that the Department of Defense had any reservations about the consent decree?

Mr. **Baxter**. That's correct.

Senator **Schmitt**. Mr. Chairman, I find that remarkable. I would suggest that we try to get that clarified with the Secretary of Defense, or some other authority. General Hilsman made it very clear, I thought, the other day, that the Department of Defense would have preferred the system as it now exists, from a national defense and emergency preparedness point of view.

The **Chairman**. He said that, as between the two, he preferred S. 898.

Although, as I recall, didn't General Hilsman say that the Department of Defense had some advance knowledge of the decree and some chance to comment on it?

Senator **Schmitt**. I'm not saying that they did not. I do not recall, though, that he indicated that they had expressed no reservations. So we ought to pursue that and find out, because there is no question about his testimony, Mr. Baxter, that the Department of Defense—at least General Hilsman, speaking for the Department of Defense—has concerns about the quality of national defense communications and emergency preparedness that they can create after divestiture. It is a more complex problem, and therefore subject to more difficulties and potentially more breakdowns within that network.

Mr. **Baxter**. I think that's true. I think, from the standpoint of network integrity, that the ideal solution would be to abolish all the independent phone companies as well, and to have a single monolithic monopoly.

I don't mean to suggest that's what General Hilsman was saying. But I think technologically, that's probably accurate.

Senator **Schmitt**. I understand that Defense Secretary Weinberger testified before the Armed Services Committee, on March 23, 1981, and insisted that a strong, integrated Bell system is vital for our national defense. He said that divestiture would be disastrous.

Ex-Defense Secretary Harold Brown testified recently, in the *U.S.* v. *A.T. & T.* antitrust case, that the Bell network is the backbone of U.S. defense. So, certainly there had been previous statements to that effect. Whether you got the same feedback when you asked them formally for a comment on the consent decree, I can't say. But certainly, Defense Secretary Weinberger has testified to that effect before the Congress.

How much time did you give the Department of Defense to comment on this?

Mr. BAXTER. I have been in frequent contact with the Department of Defense since last April or May, about the nature of their concerns. The opportunity they had to comment on the proposed modification itself was quite short, but since it was my understanding, from the extensive contact we had had with them through the summer and autumn, that their concerns had largely been addressed in the consent decree, I did not expect that it would take them long to react. And I was informed that they reacted favorably.

Senator SCHMITT. Well, Mr. Baxter, then if they did, it would seem that the Defense Department contradicted Secretary Weinberger's statement.

Did the Defense Department get as much time as the FCC got? I understand the FCC had an hour to comment.

Mr. BAXTER. So far as I know, the FCC had no opportunity whatsoever.

Senator SCHMITT. Then that's even more surprising. I would think that you might have sought their advice and counsel, since they do have some potentially overlapping responsibilities here.

Could you tell us how long the Defense Department had to study the actual proposed decree?

Mr. BAXTER. I really can't. I was out of the city. And Mr. Brown, the chairman of the A.T. & T. Co., took the decree, I believe, to Secretary Weinberger.

Senator SCHMITT. You left it to Mr. Brown to discuss this with the Secretary of Defense?

It seems to me that it might have been the responsibility of the Justice Department to communicate with the Defense Department.

Mr. BAXTER. I understand. I left it with Mr. Brown.

Senator SCHMITT. Mr. Chairman, I am incredulous. I can't think of another thing to say.

The CHAIRMAN. Senator Gorton?

Senator GORTON. No questions.

The CHAIRMAN. Don Riegle?

Senator RIEGLE. I must say that when Senator Schmitt is so incredulous that he has nothing more to say, then he really means it.

I must say that I have to share his surprise, because it strikes me that that was an assignment of some importance, and that the Justice Department itself ought to have done that piece of work. And I'm surprised that it wasn't done.

Is there a particular reason why you would not have seen that as an assignment for yourself, or a subordinate of yours reporting to you?

Mr. BAXTER. As I say, we had many, many conferences with the Department of Defense during the months preceding this event. And when we had an agreement that we felt we could live with, the question was: "Well, we can't regard this as being final until we assure ourselves that it meets the concerns of the Department of Defense, that they have an opportunity to see it."

Which I did, because I had talked to them about those concerns. And at that point, the question was explicitly discussed, whether Mr. Brown and I should go together, when we would do that. I was going to be out of the city. He said, "I'll take it out there." And then I did check subsequently, to assure that no objection had been entered, assured myself that no objection had been entered, and went on from there.

Senator **Riegle**. Let me just say that the reason that I have been in and out of the room this morning, Mr. Chairman, is that we've had the Treasury Secretary before the Banking Committee, on other important legislative proposals that the administration is presenting today. And it's been necessary to try to be there and here.

So, I want to touch on some items specifically as they relate to what is likely to happen to the cost of local phone service. I know my colleagues have raised that with you earlier in the morning.

Have you had an occasion, had the opportunity yet, to review the concerns and assessments of the public service commissions?

Certainly, the one in Michigan has been very active. I understand that either 31 or 35 State public service commissions have gotten together in a unified position, which takes issue, in major ways, with parts of the settlement.

Are you familiar, at this time, with their reservations and concerns?

Have you had a chance to take a look at that package?

Mr. **Baxter**. I have seen the testimony of the chairman of the Michigan PUC. And, on an afternoon this week—I believe it was Tuesday afternoon—I spent an hour or so talking with the representatives of what I was told was 37 commissions, about the problem. So I think, in general, that I am aware of their concerns.

Senator **Riegle**. When Mr. Brown was here last week, he said it was his professional judgment that local phone rates, under the arrangements that had been worked out, would increase less than 10 percent a year. He further went on to say—and I'm not trying to quote him precisely—to say that he envisioned increases of local rates that would be on the order of something less than $1 a month, in the period ahead—for the next immediate period of years.

That, of course, is in very sharp contrast to the concerns that others have raised, who have looked at it, including the State public service commissions, that had foreseen the possibility of rate increases that might be 200 or 300 percent increases over the same period of time.

My question to you, in light of the fact that you've got these sharply different assessments, is: What ironclad guarantees do we have—and I picked those words carefully—what absolute, ironclad guarantees do we have that will assure us that we will not have a doubling or a tripling of local phone rates over the next 2 or 3 years, if the settlement that has been worked out is left standing as is by the judge and by the courts?

Mr. **Baxter**. I would like to go back, first, to the two sharply inconsistent statements to which you pointed. If phone rates went up by $1 a month, they would go up by $12 a year. The average monthly phone bill is about $12 now. That would result in a doubling in approximately 7 years, and a quadrupling in 14 years. At a 10-percent rate of increase, phone bills would double in seven years, quadruple in 14 years.

The statement which Mr. Brown made to you, it seems to me, is entirely consistent with the statement being made by the public utility commissioners, who projected essentially a 100-percent increase——

Senator RIEGLE. Let me just stop you. What I've understood them to say—I met with the ones from Michigan yesterday—what I understand them to be asserting is that they feel that rates could go up 200 percent, double or triple, over the next 2 or 3 years. And they have used, time and again, the time period of 2 or 3 years, not a doubling over 7 years, as you were using with the 10-percent compounding factor. The two things are quite different.

Now, I take it that you think they are in error in that assessment. My question to you is: What is the absolute foolproof machinery we are going to put in place to make sure that the numbers stay within those bounds for local service?

Mr. BAXTER. They are two entirely different questions. One question is whether local phone rates are going to go up at all, or at some particular rate. And the other is whether the proposed decree in any sense causes them, or facilitates their going up. The answers to those questions are very different.

Senator RIEGLE. Or prevents it from going up.

Mr. BAXTER. There is nothing in the decree that prevents phone rates from experiencing the cost rises that phone rates would have experienced in the absence of the decree.

Senator RIEGLE. Could they conceivably be higher than the doubling over, say, a period of 7 years?

Mr. BAXTER. It is quite conceivable, although the decree would have no causal bearing, that phone rates could more than double in the next 7 years.

Senator RIEGLE. You see, I think this gets to sort of the nub of the problem, and that is: While the decree, by itself, may not mandate or cause sharp increases in a short period of 2, 3 to 4 years; on the other hand, by dismantling arrangements and machinery and the way the money is allocated within the communications system now, it could very well create the likelihood that, in fact, you would see these sharp rises.

Mr. BAXTER. No. I don't agree with that at all.

Senator RIEGLE. I would like to know why.

Mr. BAXTER. It does not dismantle. It rearranges some procedures by which money is allocated within the system, but it substitutes a new procedure for the existing procedure, which confers just as much financial room as a local public utility commission has had heretofore to pull funds back from long line services, in order to subsidize local rate services.

It is simply wrong to suppose that the decree will have any effect whatsoever on the level of rates—up, down, or sideways. It will not.

Senator RIEGLE. My concern at the moment is on just one of those possibilities. That is the question of might they sharply increase within a short period of years? What I heard you say a moment ago was, is that the decree as it's been written would not prevent that from happening. It's not designed to prevent it, and there is no foolproof machinery in the decree that would prevent it from happening.

Mr. **Baxter**. That's correct. It will not prevent it. It will not facilitate it. It will not make it either more or less likely. Phone rates will have done precisely what they would have done, and they will do it with the role of the local public utility commissioners being essentially what its role was heretofore.

Senator **Schmitt** [presiding]. Senator, could you withhold and pursue that in a moment? Senator Gorton?

Senator **Gorton**. No. I'll be glad to let him go ahead.

Senator **Schmitt**. Please go ahead.

Senator **Riegle**. Thank you. I appreciate the courtesy.

Would you be open to us building in, as an addition to what you worked out, something which would provide such a guarantee? If it were the view, for example, of the committee, we ought to make sure we have a foolproof mechanism that would prevent sharp rapid increases of local phone service costs, that we find a device here that would somehow augment the attitude which you've worked out, that would give you the assurance that you say doesn't exist at the moment now, of what you say we may well experience in terms of rate increases.

Mr. **Baxter**. You talked about the committee or the Congress preventing increases in costs. I know of no way on Earth that the Congress can prevent increases in costs. I suppose if the Congress wants to provide some explicit subsidy mechanism, that it's possible to prevent increases in prices.

Senator **Riegle**. I'm referring to prices. I'm referring to the cost to the consumer here.

Mr. **Baxter**. Oh, surely. I mean, I suppose the Congress could impose price controls on telephone service, if they wish.

Senator **Riegle**. Hasn't our whole system been a system—I mean, the reason that we're here is that we've had a regulatory system that, in effect, provides price controls for phone service? I mean, that's not a new concept. I wouldn't want the suggestion be left that somehow or another that is something that someone's proposing now. Isn't that what we have at the moment?

Mr. **Baxter**. No, it isn't, because the system we have at the moment is a system for making sure that prices are comparable to costs. It's not any sort of rigid ceiling that says prices can't go up, that they can't double in the next 10 years. They can double in the next 10 years, but they are set to be equal to costs, whatever costs may be, from time to time. It's a regulatory system that is intended to prevent monopoly profits from being derived, not set prices independent of costs. And what I'm telling you is that the costs of telephone service are quite likely to increase over time, and under our present system, prices will increase along with costs, and the decree will not affect that process one way or the other.

Senator **Riegle**. Well, there seems to be a rising body of opinion. You may or may not be correct. I mean certainly you're here to express your view and you're doing that directly, as you should. There is a rising body of concern of other folks just as serious as yourself, who have been in this business as long or longer, and I'm speaking of people who are on the State level in these public service capacities, who feel that the change in arrangements present a real possibility of very rapid increase in costs for local service coming quickly. You don't foresee that. Many of them do foresee it.

And what I'm concerned about is making sure that we have a mechanism in place that provides some protection against anything that would be 200 or 300 percent increase over a period of, say, the next 2- to 4-years' period of time.

We haven't discussed that directly. If we were to find ourselves in a situation where costs to the consumer were being driven up that fast within that frame of time, would it be your view that we ought to try to do something to deal with that, or would you be of the view that we ought to just take that in stride, if that's what happens?

Mr. BAXTER. I would have to see. As I say, the only thing one can do, if real costs, as opposed to prices, are rising that rapidly and nothing else would make a price rise that rapidly, then the only thing one can do is to create some explicit subsidy mechanism and couple it with price controls. And I would have to see the scheme before——

Senator RIEGLE. You see, now it had been my view that, in effect, we've had a system that has some character such as that. We've had a situation where Long Line revenues have been used to help hold down the costs through the cost allocation, to hold down the price of local phone service. You're changing those relationships and, in fact, you're saying that what will happen will happen. But you just don't have as dire a view as to how severe that may be, as others. There are a lot of things happening here. We're accelerating depreciation schedules. We're doing many things to change the cost picture, in terms of what costs hit which user in what time period.

And I think, frankly, despite all the hard work that's been done, that unless there is a realistic addressing of that problem which holds water with those people out there who are concerned about this issue, you're going to find this thing gets in deeper and deeper trouble.

Now you may say that's not as it should be, or you may not even want to accept that as a notion, but I think you're going to find it to be the case, and I'd like to have a more direct answer than what I've heard today.

Mr. BAXTER. I can accept that as a notion, Senator. What I cannot accept as a notion is the fact that long lines service is any less available to the regulators after the decree is entered than it was before the decree is entered, because there is provision in the decree, as I've said several times this morning, for access charges which are subject to control of the regulator, which are as susceptible to being used for the purpose of cross-subsidizing local telephone service, to the extent that's thought to be a wise thing to do, as the old separations and settlements process ever was, and a good deal more efficient.

Senator RIEGLE. Just one final question for you, if I may, and I appreciate the chairman's patience. What is your prediction, your best professional prediction coming off your staff work, as to what you think the likely rate of increase will be of local phone rates over the next 2, 3 or 4 years?

Mr. BAXTER. I would expect phone rates to increase in real terms, as opposed to nominal terms, by 1 or 2-percent a year. I would expect them to increase in nominal terms by 1 or 2 percent, plus the inflation rate, whatever that is.

Senator **RIEGLE**. Can you convert that to a measure of dollars per month in cost or a percentage increase in the cost that a consumer would pay for basic telephone service?

Mr. **BAXTER**. Yes, I can. Do you want it in nominal terms or in real terms?

Senator **RIEGLE**. Let's have it both ways. What we're trying to do here is to unconfuse the issue so that people out there, who have a hard time coping with those terms, can try to somehow equate this to what it's going to mean in terms of how big is their phone bill going to be, 6 months, a year or 2 years from now.

Mr. **BAXTER**. I have to make some assumption about what inflation is going to be.

Senator **RIEGLE**. I understand.

Mr. **BAXTER**. Let me assume, optimistically, that inflation is 8 percent per year, and that we get a 2 percent real increase. I have a nominal increase of 10 percent per year. In that event, phone bills will double in 7 years. In real terms, if it's increasing at 2 percent per year, that would correspond to perhaps $0.20 a month or $2.50 a year. And it would be a much longer period of time before doubling occurred, something on the order of 30 years. The old rule of thumb I use on 10 percent doesn't work as well when you get down as low as 2 percent, so I can't be quite as precise.

Senator **RIEGLE**. I appreciate your being that specific.

So what you're saying then is, if one assumes that we were to run at an annual inflation rate of about 8 percent, you would expect that under the decree that you worked out here, the arrangements that you've worked out——

Mr. **BAXTER**. Under and out from under.

Senator **RIEGLE**. However you wish to put it, that 7 years from now, you would expect it would take that long before we would actually see a doubling of local phone service rates or the cost to the consumer. That's your best estimate as to what is likely to occur here, if one projects an 8 percent annual inflation rate.

Mr. **BAXTER**. I think that's right.

Senator **RIEGLE**. Just one other thing. That's your best projection now in terms of what you foresee. In other words, you see, on the average, a 2 percent increase in real cost, plus whatever the inflation factor is, but as you look at the impact of the settlement, that's your best judgment as to the cost line that you will be on, as it would impact the local phone users.

Mr. **BAXTER**. I think that's right.

Senator **RIEGLE**. I thank you.

Mr. **BAXTER**. Those are all pretty much off the cuff. Those are not based on any study that was really intended to answer that question.

Senator **RIEGLE**. Well, wouldn't it be useful to maybe try to do a study that can answer the question, so that it isn't off the cuff? I mean, it's a big question. It's an important question, and why should we have to deal with an off-the-cuff judgment on this? Why not put somebody to work to see if we can't generate some careful analysis?

Mr. BAXTER. Well, all one could do is look at the rate at which costs have changed in the past. Future cost projections make all sorts of assumptions about rates of technological change. And to what extent bypassing of the long-distance network by microwave technology or the local loop by microwave technology is feasible—you know, there's enormous inherent uncertainty in efforts of that kind.

Senator SCHMITT. Senator, I'm informed by staff that the NTIA is performing a general study for us on that subject. I don't know when it will be available, but we'll see what they say.

Senator RIEGLE. My thought would be this. I think that the Justice Department itself ought to have its own analysis.

Senator SCHMITT. One would think they would have done that before they proposed the decree.

Mr. BAXTER. Since we're leaving it unaffected, we didn't see any reason to do that.

Senator SCHMITT. You also realize, Mr. Baxter, that there are some differing opinions.

Senator RIEGLE. That's the cross-check. The value of the analysis is that then when the public service commissions come in with their analysis, and they say, "Wait a minute. You're really disrupting the game," and you're going to have this kind of an impact. I don't want to have to ask you to take the shirt off your back, so that we can take the off-the-cuff analysis here. We ought to have something, I think, that's more precise than that. And I think it would be useful to have it, frankly.

Mr. BAXTER. I'm quite prepared to talk in some detail about whether the decree can, just as a matter of logic and procedure, affect telephone rates at all. The answer to that question is no, but I have not made any long-term cost projections, partly because it's not our business and partly because I regard them as inherently unreliable, when made.

Senator SCHMITT. Mr. Baxter, was there any reason for the Defense Department to know that divestiture of the nature in the decree was contemplated prior to the delivery of the consent decree to them?

Mr. BAXTER. I guess I would say no.

Senator SCHMITT. Doesn't it strike you as a little bit weird to have a defendant in this case to take the news of the decree to the Defense Department?

Mr. BAXTER. No. They have very good and close relationships with the Defense Department.

Senator SCHMITT. Thank you. Senator, any further questions?

Senator RIEGLE. I have a number of questions for the record. Mr. Baxter has been very patient and has been here quite some period of time.

Senator SCHMITT. And there will be other questions for the record.

Senator RIEGLE. Exactly. So I will—rather than go into them now, I have a whole series here I'd like to have addressed and responded to.

Mr. BAXTER. I'd be happy to.

Senator SCHMITT. Thank you. Thank you, Mr. Baxter, the hearing is adjourned.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

MOHAWK, MICH., *January 12, 1982.*

Senator DONALD RIEGLE, Jr.,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR RIEGLE: The Michigan Public Service Commission has been holding public hearings regarding the deregulation of AT&T and the proposed increases in Michigan Bell Telephone rates. They are asking people to write their Legislators voicing opposition to Senate Bill covering this deregulation, thus my letter to you.

Michigan Bell is proposing increases in monthly phone bills of from 100 percent to 300 percent—a monthly bill of $8.85 will go to $20.08. With an increase like this, it will be a luxury to have a phone in your home. This will be a charge for having your equipment hooked to Bell lines. You will have to purchase your own phone and lines, etc. Service will be nil.

I think this is very unfair, the taxpayer has to always pay and pay. Will it ever end? As you undoubtedly know, most of the people living in this area are on Social Security or other fixed income and will not be able to afford a telephone with this kind of rate. It will really create a hardship for a lot of people, especially those who rely on the phone for emergency use most of all.

I don't know all the reasoning behind this Senate bill and the Anti-trust suit against AT&T but I am asking you to vote "No" and perhaps help keep the rates down to a reasonable degree. It will really create a hardship for a lot of people.

Anything you can do will be most appreciated. Thank you for your time.

Sincerely,

MARIE E. LEMPEA.

HOLLAND, MICH., *January 15, 1982.*

DEAR MR. RIEGLE: It has come to my attention that phone rates will triple if AT&T has its way. I sincerely pray that you will fight this issue.

The average wage earner and the elderly don't stand a chance any more. I see it and hear it every day. "What can we do?" They are deeply concerned but I wonder how many would spend twenty cents to tell you?

The U.S.A. is too great a country to make it a feudal system.

Sincerely,

MRS. B. SMOLEN.

ESCANABA, MICH., *January 18, 1982.*

Hon. DONALD RIEGLE,
Russell Office Building,
Washington, D.C.

DEAR SIR: I am writing you to protest the latest deregulation rip-off. It seems Washington has suddenly decided to deregulate everything, which is usually bad news for the consumer. One would think the government would put more thought into such important matters before "tinkering" with these rules and regulations. It seems very apparent much more thought was put into the regulations than the deregulations.

A good case in point is the recent decision by Justice to hack the well-regulated Bell System into bits and pieces. AT&T was allowed to keep the corporate "cream", while the affiliated companies seem to be left with the milk. Now companies, such as Michigan Bell, must double or triple local rates, as they can no longer be subsidized by Mother Bell's lucrative long distance calls. The best telecommunications system in the world is now heading in twenty-three different directions, thanks to government meddling.

You are probably already aware this area is witnessing a gradual withdrawal of our only major air carrier, due to deregulation, and we have been warned to expect natural gas prices to double or triple soon for the same reason.

Between the recession, inflation and government tinkering with regulated industries, the taxpayer is taking quite a beating. As my elected representative in Washington, I would hope you would put the full power of your office behind the rectification of these governmental errors by swiftly passing corrective legislation.

Most sincerely yours,

DONALD ALLARDYCE.